AMG Market Commentary

November 2010

The second round of quantitative easing is coming for U.S.

As expected, the Fed announced on Nov 3 that they are going to put the second round of quantitative easing into work. What they have committed is to add an extra USD 600 billion to the planned asset purchase and the new money will be spent before the end of Q2 2010. Besides, the Fed has also said that if the expanded asset purchase still fails to speed up the recovery of the economy and the job market, it is ready to give the economy more stimulus.

Besides the decision of the Fed, the reaction of the other major countries was no less a concern for investors. And the results were, centrals banks for U.K., Eurozone and Japan all keep them asset purchase plan unchanged and refrained from any change to their interest rate. So, the reaction to U.S. expansion of quantitative easing is nothing radical and investors took a breath.

The immediate reaction of the financial market is that U.S. dollar turned down again. And the at the same time stock markets, commodities prices and non USD currencies jumped. What we expect is that more liquidity pumped in by the Fed shall drive asset prices higher. Admittedly, the risk for asset bubble to form is not negligible. Still, for the stock markets, we have found that PE ratios are just close to long term averages and we can hardly say a bubble is already formed. Thereby, we still favour equities to other asset classes. And strong growth of the emerging markets are still attracting more capital inflow and they still represent better growth opportunities for investors too.

US : Positive

The Democrats was beaten bitterly in the mid-term election. The Republican has reclaimed control of the Senate, it means that the Obama administration will need their support to adopt new policies. For the corporations and the richer class, it is a good news. The Republican is more prop-business which we can from their stance to support extension of tax cuts for high income American and opposition to Obama's medical care reform. We expect the Obama administration will have to compromise with the Republican on policies that will hurt the U.S. corporations.
The job figures were giving investors a surprise. In Oct 2010, private payrolls rose by 159,000 and the overall non-farm payroll figures rose by 151,000 too. Both figures came in above expectations and the non-farm payroll number returned to positive growth. The change was favourable yet with unemployment rate hovering at 9.6%, it will take months of continuous strong growth in payrolls to bring down the unemployment.

Europe : Neutral

The debt problem of the peripheral Europe came back again, concerns about Ireland fiscal budget continues. The story is that Irish government is now trying to push through more stringent fiscal spending cuts but it faced strong opposition in the Parliament. The struggle over the new fiscal budget is pushing up government bond yields for Ireland and it is one of the factors that contributed to the adjustment in global stock markets. Still, the Euro Commission has launched a stabilization fund that worth EUR 750 billion together with the IMF. It is estimated that the stabilization will be sufficient help the peripheral countries to meet the re-financing needs in the next 2 years. So, we do not expect the quarrel over Irish government budget will trigger a crisis immediately.

China : Positive
Manufacturing PMI turned up to 54.7 for Nov. It is the third increase in a row since the PMI bottomed out at 51.2 in July 2010. The figure showed that Chinese industrial production growth is picking up again. At the same time, the new order index rose to 58.2. It also points to better growth prospect from coming months.
Besides, PBOC lifted the required reserve rate by another 0.5%. For the large banks, the RRR will be 18%, the highest level ever. Obviously, monetary policies are being tightened in China. Still, valuations is just fair for both Hong Kong and China stock market from a historical perspective and corporate profits remains in a uptrend. We do not expect the bull trend will be toggled by tightening of monetary policies.

Hong Kong : Positive
Emerging markets are lifting their interest rates to combat the risk of higher inflation and asset bubble in anticipation that the U.S. will expand the quantitative easing operation. But, it is not an option for Hong Kong with the currency peg in place. And the exchange rate risk for USD based investors is essential removed by the currency peg. We can expect assets in Hong Kong shall be a prime target for international hot money. And thus, property prices and stock market shall likely have another rally as capital flows in.

Emerging Markets : Indonesia : Positive, Brazil : Positive
Ms Rouseff, the candidate from ruling Workers' Party won the race for presidency in the second round voting. Before Rouseff's victory, the Workers' Party has secured the absolute majority in the National Congress together with it alliance. So, the Workers' Party managed to keep its absolute advantage. It helps to reduce the political risk for Brazil and Rouseff is now in a strong position to start her proposal to trim public spending for a more sustainable fiscal position of the government.

Commodities : Positive
The impact of USD on commodities becomes very obvious again. While the USD slides, it helps commodities prices. Gold price climbs over 1,400/ounce and crude oil stands above USD 86/barrel.

Hedge Fund : Neutral
Barclay Hedge Fund Index rose by 1.99% in October. Long bias strategy continued to out-perform compare to other strategies as stock market kept rallying. Last month, the Barclay Equity Long Bias Index gained 2.90%. And the best perform in year 2010 is Barclay Convertible Arbitrage Index which grew 11.07% so far in 2010.

Government Bonds : Negative
According to the announced plan for the second round of the quantitative easing, the Fed's asset purchase will be concentrated in Treasuries issues with less than 10 years term. And it resulted in a divergence in performance in U.S. government debt with different terms. Short to medium terms issues rose as investors expect higher demand from the Fed. While on the other hand, longer terms issues e.g. 30 years Treasuries debt fell as investors fears about the revival of inflation.

Things to Look Forward :
As expected, the Fed announced that it will expand the quantitative easing operation. And the USD weakened immediately after the announcement. At the same time, equities, commodities and non-USD currencies all started a rally. We expect the injection of more liquidity by the Fed shall benefit asset prices.
On the other hand, a weakening USD and the fear of inflow of capital may trigger more radical reaction from other countries. The response by other countries may trigger more fluctuations in the financial markets.

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

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