AMG FINANCIAL GROUP

AMG Market Commentary

February 2014

<u>The Ukraine Crisis will not cause a great impact to the global economy as well as the global financial markets</u>

The political situation in Ukraine has worsened significantly over the past few days. Originally, investors thought that the Ukraine issue would be settled as a compromise was reached between the ruling party and the opposition party. Suddenly, the political situation has changed dramatically as the President was ousted by the opposition. As the President was pro-Russia, the ouster was regarded as an unfriendly behavior to Russia. Therefore, it has triggered Russia to react and Russia even becomes possible to have a military intervention on Ukraine.

As Russia may have a military intervention on Ukraine, the U.S.-led Western powers have immediately accused Russia of such military intervention. Apart from verbal accusations, they have threated to impose diplomatic and economic sanctions to Russia if Russia does not stop the invasion.

As a result, the Ukraine issue has changed from a regional crisis to a global crisis. It has involved the two Superpowers in the world – U.S. and Russia. It has also caused market panic in the financial markets. For example, the Russian stock market has dropped more than 10% on 3 Mar and the global stock market has also dropped 2-3% in the same day.

Russian Stock Market Index

Sources: Bloomberg

No need to be too panic!

First of all, such kind of regional conflicts were quite common in the past 10-20 years. What was happening in Ukraine now is not strange to most experienced investors. We have experienced similar situations in Middle East, Asia & Africa before. According to the past experience, the conflict will likely remain at the regional level and will not be further expanded. It is because for those Superpowers, such as U.S., UK, France, China & Russia, they all understood that they cannot expand the conflict to a global level as the consequence will be very destructive.

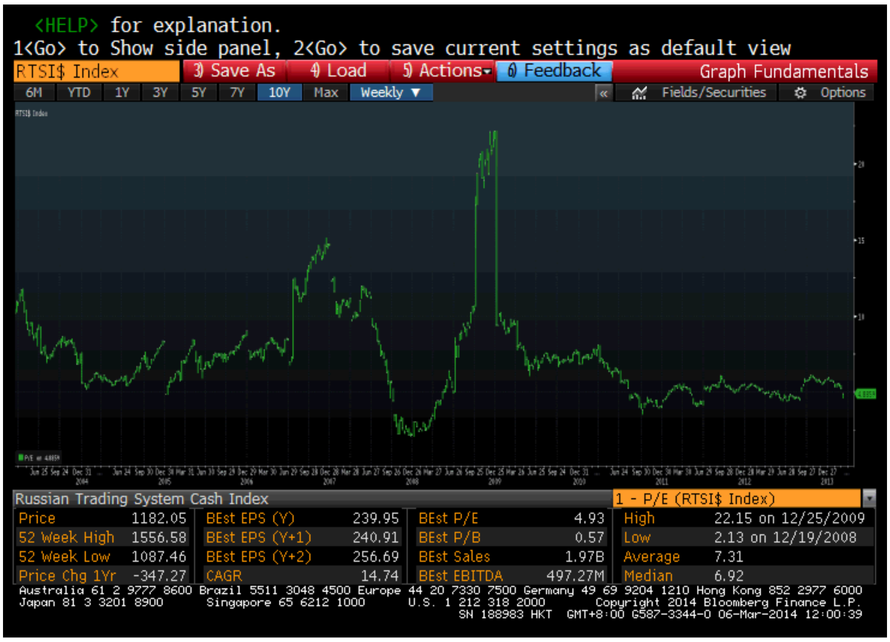
War between those Superpowers is impossible. Due to the mass destructive weapons, a war between the Superpowers will only result to the end of the world. Step backward, a diplomatic or economic sanction is also highly impossible as it will have a great impact to the global economic growth. For example, a UK reporter has said that the British government has concluded that they will not impose any economic sanction on Russia at this moment as it will hurt their economic growth.

Thus, we are quite sure that the Ukraine issue is just a storm in a teacup. Although we are not sure what will happen to Ukraine in the future (the ruling party wins or the opposition party wins), we are quite sure that the conflict between U.S. and Russia will not be exaggerated and the conflict will be limited as a regional issue. Therefore, it will not cause a great impact to the global economy as well as the global financial markets.

Impact to Investors
For most investors, we expect the negative impact to them will be limited to their investment on Eastern European or Russian market (for those who have such investment). Although the Ukraine Crisis has shocked the global financial markets and caused a substantial market correction, investors have been calmed down quickly and the negative impact to the global financial markets has been disappeared. Apart from 3 Mar, which the global stock markets have corrected 2-3%, the global stock markets have resumed stable in the following trading days. On the other hand, the Russian stock market has still dropped 7% even though the market has rebounded more than 6% the day after the 10%+ crash on 3 Mar. If we count the drawdown happened in Jan as well, the Russian stock market has recorded about -20% YTD losses.

We expect the struggle between the U.S. and Russia will be eased in a few weeks later. However, even though no war, no serious sanctions were eventually happened between U.S. and Russia, the relationship between Russia and the West will be more or less affected. Besides, in terms of stock market performance, we expect the Russian stock market will be the only loser. We do not believe the Russian economy will be seriously affected by this incident. It is because Russia is a relative closed economy. Even though the incident may decrease the capital inflow to Russia, the impact to the economy is very limited. However, with less inflow from foreign investors (or more outflow from foreign investors), it will further weaken the momentum for Russian stock market. Thus, we expect the Russian stock market will continue to be underweighted and the price will continue to be undervalued for a certain period.

PE Ratio for Russian stock market: less than 5x PE



Sources: Bloomberg

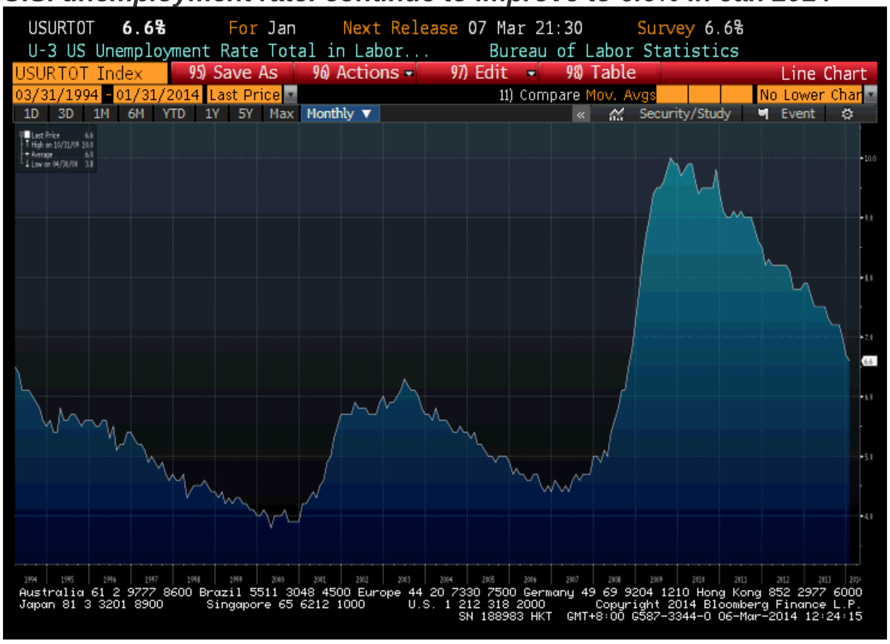
We expect in the coming 3-6 months, the performance for Russian stock market will likely underperform the global market. We also expect it may take 3-6 months for the Russian market to recover from its recent loss.

Economic Review and Market Outlook

U.S. Economy and Financial Market:
Some economic data reported in Jan and Feb showed that the U.S. economic growth was slowing. However, most investors have got used to these not very good data and explained that the not very good data were mainly due to the severe weather. As a result, even some data were worse than expected, no significant market fall was happened in Feb (but in Jan, the market has corrected almost 5% due to disappointing economic data).

Apart from looking at the economic data, investors were also focused on the speeches from Janet Yellen, the first chairwoman for the U.S. Fed. In her speeches to the U.S. Congress, she reconfirmed that she would maintain a relative loose monetary policy for a certain period in the future. She also reconfirmed that unemployment rate was not the only indicator for the Fed to decide its interest rate movement. She said that even though the unemployment rate drops below 6.5%, it is not a must for the Fed to raise the interest rate. She will also consider the changes in general price level as well as other figures for the job market. Her speech has pleased most investors and it has a positive effect to the financial market.

U.S. unemployment rate: continue to improve to 6.6% in Jan 2014



Sources: Bloomberg

We believe U.S. will maintain its steady economic growth in 2014 with expected GDP growth rate of about 2%.

EU Economy and Financial Market:
The political crisis in Ukraine did not affect the economic momentum in EU. Under the leadership of Germany, the outlook for EU economy remains bright this year.

The CPI figure for EU was 0.8% in Jan 2014 which was the third successive month for the figure to below 1%. As a result, some investors started to concern about the risk of "deflation". In our opinion, we are not too worried about the risk of deflation. It is because the EU economy is recovering. We are quite confident that EU economy can recover in 2014 from the recession in the past years, though we only expect a 0.5%-1% GDP growth in 2014.

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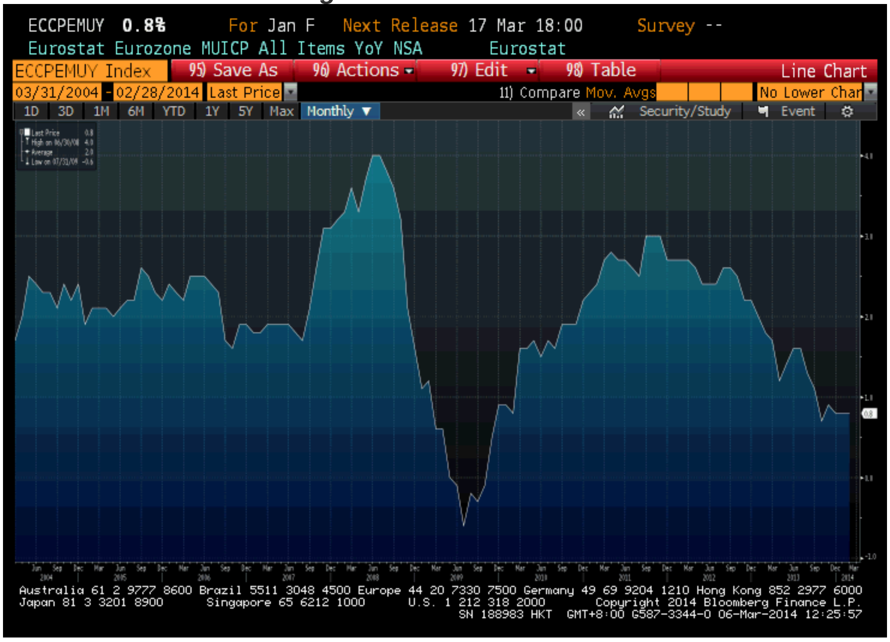


Sources: Bloomberg

Although we just expect a 0.5%-1% GDP growth in 2014, it will be enough for the stock market to have an outstanding performance. It is because we are not talking about the GDP growth hike from 2% to 2.5% or 3%, we are talking about the economy recovers from recession to growth (change of status). Therefore, we have a more positive view on European stock market in 2014.

Japanese Economy and Financial Market:

Starting from 1 Apr 2014, the Japanese government will increase the sales tax from 5% to 8%. Some investors worry that the tax hike will hit the recent economic recovery.

We need to emphasize that we do not have a very positive view on the Japanese economic outlook. We do not expect the Japanese economy can resume high growth just due to a looser monetary policy. It is because the long-term economic recession happened in Japan was due to a series of problems. The depreciation of yen alone will not solve all the problems and it is also impossible for it alone to reverse the economic downtrend.

Although we have suggested investors to buy Japanese stocks since Jan 2013, it did not mean that we had a very positive view on the Japanese economic outlook. In contrast, we had a neutral view on the Japanese economic outlook. We regarded the Japanese stock market as an opportunity in Jan 2013 because we expected that the revaluation effect from a cheaper yen (a cheaper yen will increase the revenue and profit, as well as their shares price of most exporting companies in Japan) will have a very positive effect to the Japanese stock market. Thus, although the sales tax hike in Apr may hit the economy, we are not too worried, as long as the weak-yen policy remains unchanged. We are quite confident that the stock market can rebound from its recent correction.

Japanese yen: we expect the yen will remain low under the loose monetary policy. As a result, it remains a very positive factor to the Japanese stock market

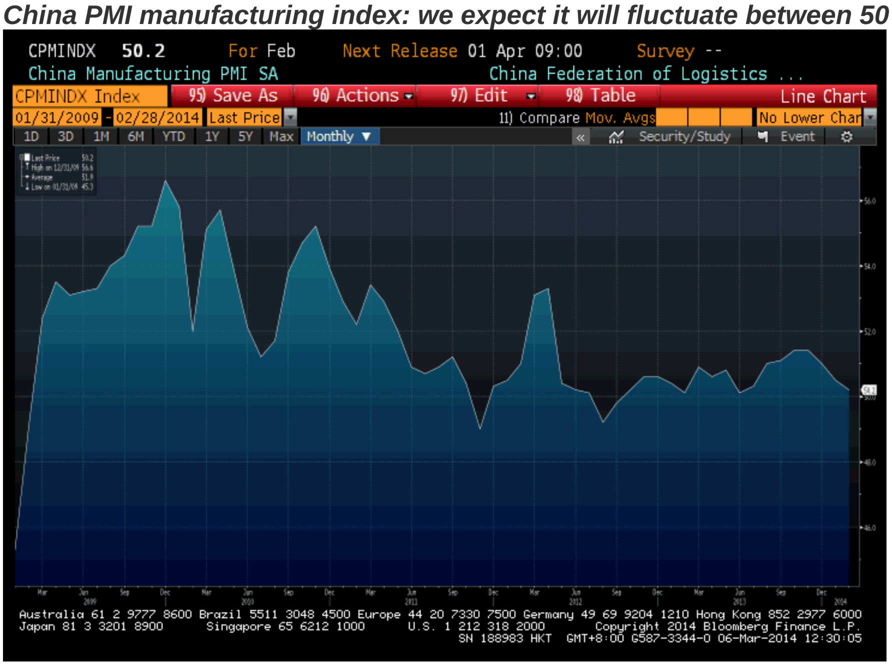
Sources: Bloomberg

China Economy and Financial Market:

The Congress Meeting held in early Mar was one of the focuses for the global financial market. So far, no major economic policy was announced. However, we are more and more confident that the economy has reached the bottom last year. It is because in the meeting, the Chinese government has shown that it does not want the economy to decline further as it will lead to a so-call "hard landing". Therefore, although we do not expect the government policies will change from tightening to expansionary, it is highly possible that the government policies will be less restrictive in 2014. It will have a slight benefit to the stock market.

We expect the economy will remain at 7% growth most of the time in 2014. We also expect most of the economic data, such as PMI manufacturing index will fluctuate between "expansion" and "contraction" (For PMI, if the index is above 50, it means the sector is expanding; if the index is below 50, it means the sector is contracting).

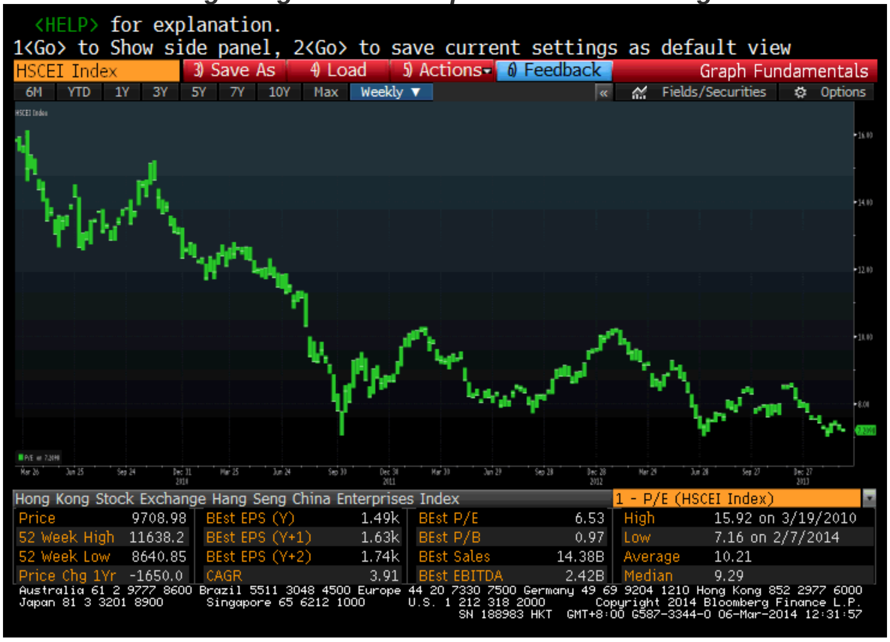
China PMI manufacturing index: we expect it will fluctuate between 50 most of the time in 2014.



Sources: Bloomberg

However, it is a good timing to invest on the Chinese stock market, such as the Hang Seng China Enterprises Index. It is because it is trading at less than 8x PE (deeply undervalued). We expect the index can rebound to 11,500 in the coming 6-9 months, with potential return of 10-15%. If the index rebounds to 11,500, it still trades at less than 9x PE (still undervalued).

PE ratio for Hang Seng China Enterprises Index: trading at around 7x PE which is very cheap



Sources: Bloomberg

Economy and Financial Market in Emerging Markets:
The emerging stock markets have rebounded substantially in Feb after the plunge happened in Jan. For example, the MSCI Emerging Index has recorded 3% rebound in Feb 2014 (though the index is still down 3% YTD).

MSCI Emerging Index

Sources: Bloomberg

We expect that the global fund flows will remain negative to most emerging markets at least in the first half of 2014. It will have a negative impact to most emerging stock markets as fund flow will remain flowing out from emerging markets to developed markets.

However, it does not mean that emerging markets are lack of any selling points. At least, it is cheap in valuation. After the recent market correction, some emerging stock markets have corrected excessively and their valuations are already very attractive. Although the market sentiment is still very weak and the short-term performance may still lag behind, it can possibly provide a decent return to investors if they can hold it for a longer period of time, like 9-12 months.

Commodities:
Commodities are the only few investment vehicles which has been benefited by the chaos in Ukraine.

Oil price: Oil price has increased as investors were worried about the possible struggle between U.S. and Russia on the Ukraine Issue. Investors were afraid that if the Ukraine Crisis becomes more severe, it will affect the global supply of oil, especially for Europe. As a result, the oil price has increased due to risk concern. For example, the NYMEX crude oil price has increased to US$105 from US$96. The Brent crude oil price has increased to US$112 from US$106.

We suggested investors should not chase the oil price at the current level. It is because the recent uptrend may be short-lived. The recent increase in oil price was mainly due to the political crisis in Ukraine. Once the political situation stabilized, the oil price may correct back to the pre-crisis level as the fundamentals (global demand and supply) remain not too strong or not strong enough for the oil price to have a significant increase. Thus, it is very likely that the NYMEX crude oil price will drop back to US$90-100 and the Brent crude oil price will drop back to US$105-110.

NYMEX crude oil price

Sources: Bloomberg

Gold price: Risk-averse investors have increased their demand for gold due to the Ukraine Crisis. Gold price has increased from US$1,250 in the early Feb to US$1,350 in the early Mar. However, we expect the recent hike in gold price will be short-lived as well. Once the political situation stabilized, the correction in gold price will be likely to happen.

Gold price

Sources: Bloomberg

* Unless otherwise stated, all figures and information are collected from WSJ, Bloomberg or Haver Analytics.

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