AMG FINANCIAL GROUP 安柏

AMG Market Commentary

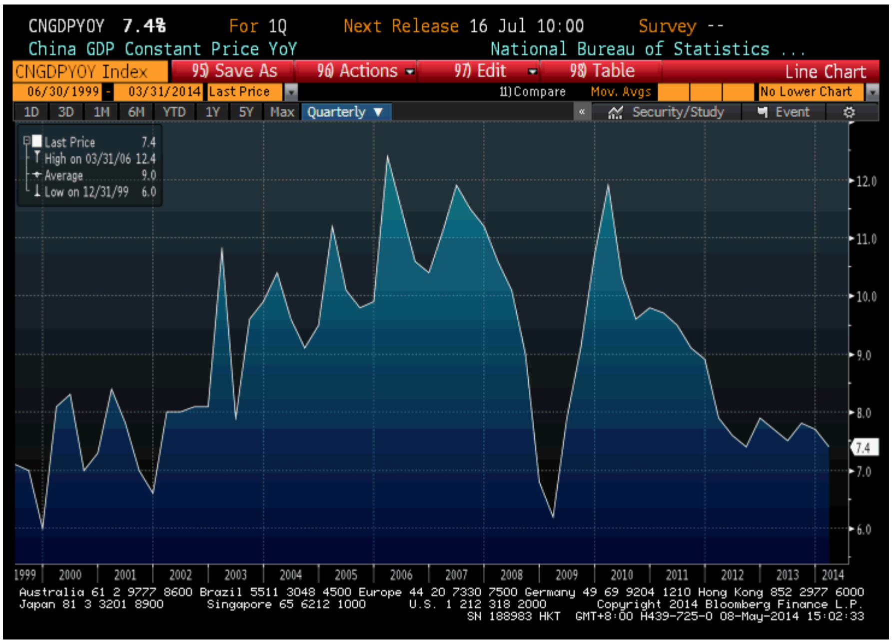
April 2014

A Different Economic Trend, A Different Investment Strategy

The China and HK stock markets have continued to underperform in 2014 (YTD). It was mainly due to the continuous weak economic performance for China.

In Apr, the China Government has released the GDP figures for Q1 2014. The GDP growth for Q1 2014 is 7.4% which is better than market consensus of 7.3%. However, the GDP growth has dropped if we compared it with the growth rate of 7.7% in Q4 2013.

China GDP Growth



Sources: Bloomberg

Indeed, most investors did not feel any surprise for the relative low GDP growth in Q1 2014. It is because before the release of GDP figures, many other economic figures have already shown that the economic growth remained weak in Q1 2014. For example, the HSBC PMI Manufacturing Index was 48.1 in Apr. Besides, it has been below 50 (below 50 means the sector is contracting) since Jan 2014. In addition, other economic data, such as Fixed Asset Investment, Industrial Production, Retail Sales and Export all showed that the weak performance will pursue.

HSBC China PMI Manufacturing Index

Sources: Bloomberg

We expect the China economy will continue to slow down in 2014. It is mainly due to the slowdown effect from a series of economic reforms implementing by the China Government. For example, the China Government is implementing reforms for economic restructuring (promote manufacturing sector to higher value-added), reforms on financial and banking regulation, and reforms for reducing credits expansion on non-banking sector. Both of them will be benefit to the long-term economic health in China. However, it will lower the short-term economic growth.

Most importantly, the above reforms are not a small project. It will take at least a few years to complete. As a result, it is expected that the economic growth will continue to be impacted by the side-effect from the reforms. We expected the economic growth will be between 7-8% in the coming 1-2 years. It is because if the economic momentum increases, it is highly possible that the China Government will speed up the reform progress and the better economic momentum will soon be offset by a more slowdown effect.

We Have To Adjust Out Investment Strategy

Investors have become less confident on the China and HK stock markets as the economic outlook for China remained weak (though the valuation is already at a very attractive level for both China and HK stock markets). As a result, it will significantly limit the upside potential for both markets. For example, the Hang Seng Index was trading between 18,000-24,000 most of the time in the past years. We expected that it is highly possible it will continue to trade between 19,000 and 25,000 in 2014.

Thus, we may have to adjust our investment approach in order to adopt the different economic trend at this moment. For example, we will encourage “buy and hold” in the past as the China market is a growth story and investors can usually have a decent gain in a 3-5 years investment (with a quality China Equity Fund). However, as the economic growth for China will remain weak in the coming years and will not return to high growth anytime soon, “buy and hold” approach may not continue to be a good way to invest on the China stock market. In order to adopt to the current economic trend, we suggest apart from the “buy and hold” approach, investors can use some investment budget by a more dynamic approach. In the past 5 years, the Hang Seng Index was trading between 18,000-24,000 most of the time. If we set 20,000 or below as the entry point and 24,000 as the target for profit taking, we have made three tradings in the past 5 years and the total return was 60% (vs. 10% for “buy and hold” approach)

HK Hang Seng Index (Past 5 Year Performance)

Sources: Bloomberg

Economic Review and Market Outlook

US Economy and Financial Market:

In Apr, the US Government has released the GDP figures for Q1 2014. It was surprise to the market that the GDP growth was 0.1% only (the market consensus was +1.2%). However, as most investors believed that the worse than expected GDP growth was mainly due to the severe winter and thus the worse than expected GDP growth did not cause a crash in the stock market.

US Economic Growth

Sources: Bloomberg

Indeed, the economic momentum was not as bad as shown by the GDP growth figure. It is because most of the economic figures have shown that the US economy is having a solid growth in 2014. For example, PMI Manufacturing Index has increased from 51.3 in Jan to 54.9 in Apr. It is the 17 successive months the index was above 50 (above 50 means the sectors is expanding). Durable Goods Order have recorded 2.9% growth in Mar 2014. It is the biggest growth in the past 6 months. Besides, Nonfarm Payroll has increased 288,000 in Apr 2014 which is much better than market expectation and is also the highest since Feb 2012.

US PMI Manufacturing Index

Sources: Bloomberg

US Nonfarm Payroll

Sources: Bloomberg

US Unemployment Rate

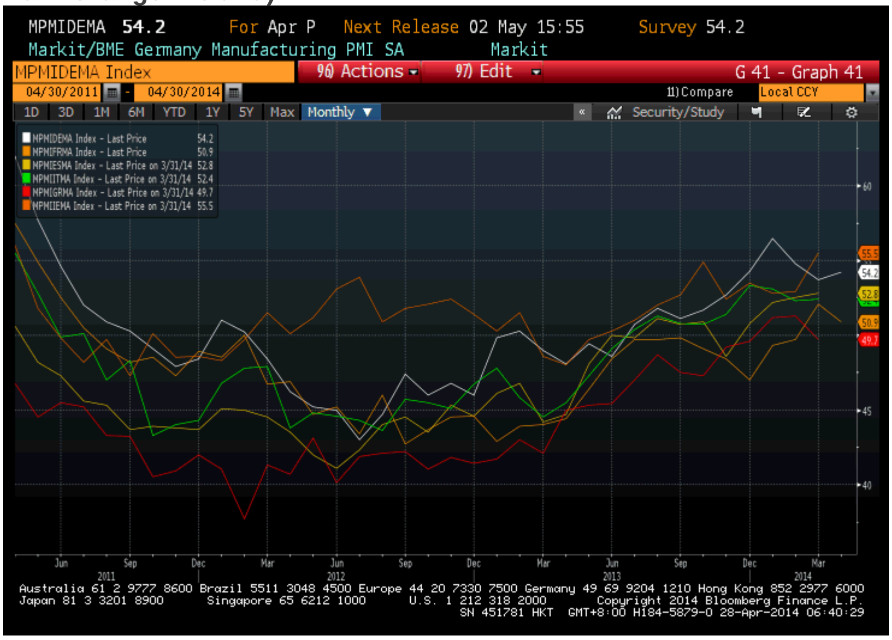
Sources: Bloomberg

The outlook for Monetary Policy: Although the unemployment rate has improved to 6.3% in Apr and was better than the 6.5% reference point set by the Fed previously (the previous Fed Chairman Bernanke has mentioned that the Fed may consider to raise the interest rate if the unemployment rate has improved to below 6.5%), we are quite confident that the Fed will not speed up the tapering just due to this better than expected unemployment rate figure. It is because Yellen has said very clearly that she would not just focus on unemployment rate. She will consider the whole job market (no. of jobs as well as the quality of the jobs) including but not limit to labor force participation rate, underemployment rate, no. of long-term unemployed, increase of hourly earnings, etc. As what she mentioned in the testimony for the US Congress, she said that the job market is still far away from a full employment and thus the Fed must remain its loose monetary policy.

EU Economy and Financial Market:

The EU economy continues to recover in 2014. Germany and France remains the leader for the economic recovery. Apart from these two, other EU countries are also showing substantial improvement in the past few months. For example, PIIGS are having a stronger economic momentum. The PMI Manufacturing Index has been increased for Spain, Italy, Greece and Ireland (and both indices for Spain, Italy and Ireland were above 50, it means that their manufacturing sectors are expanding now). It is a good signal that the recent economic recovery in EU was not just concentrated on a few countries, it was a general recovery happening in most of the countries in EU.

EU PMI Manufacturing Index (White: Germany; Orange: France; Yellow: Spain; Green: Italy; Red: Greece; Dark Orange: Ireland)



Sources: Bloomberg

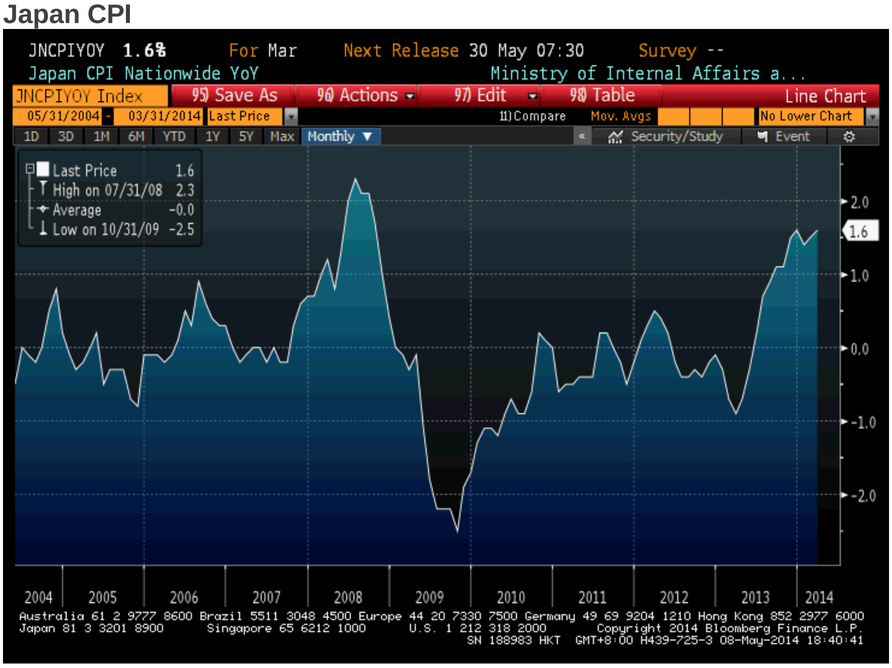
Japan Economy and Financial Market:

BOJ has just completed its monetary policy meeting on 30 Apr. After the meeting, it announced that it would maintain the monetary policy unchanged. It will continue to conduct money market operations so that the monetary base will increase at an annual pace of about 60-70 trillion yen.

Of course, the decision from BOJ was disappointing for most investors. It is because investors have expected BOJ would increase the market operations to further support the economic recovery/ growth. However, we regard it is quite logic for BOJ not to increase the market operations at this moment. It is because BOJ need to take time to observe the negative impact from the raising sales tax (since Apr 2014) before it decides the next policy decision. Therefore, we believe that BOJ will eventually increase the market operations. It is just waiting for the right timing. It is highly possible in 2nd half or Q4 of 2014.

The CPI figure was 1.6% in Mar 2014. It is very near the 2% inflation target set by the BOJ. Of course, BOJ do not just want to have a positive CPI. It is hoping that a positive CPI will create a positive momentum to the economic growth. The GDP did have a rapid growth in Q1 and Q2 2013. However, it has slowed down in Q3 and Q4 2013. Therefore, we believe that in order to support the economic growth, BOJ will eventually increase the market operations.

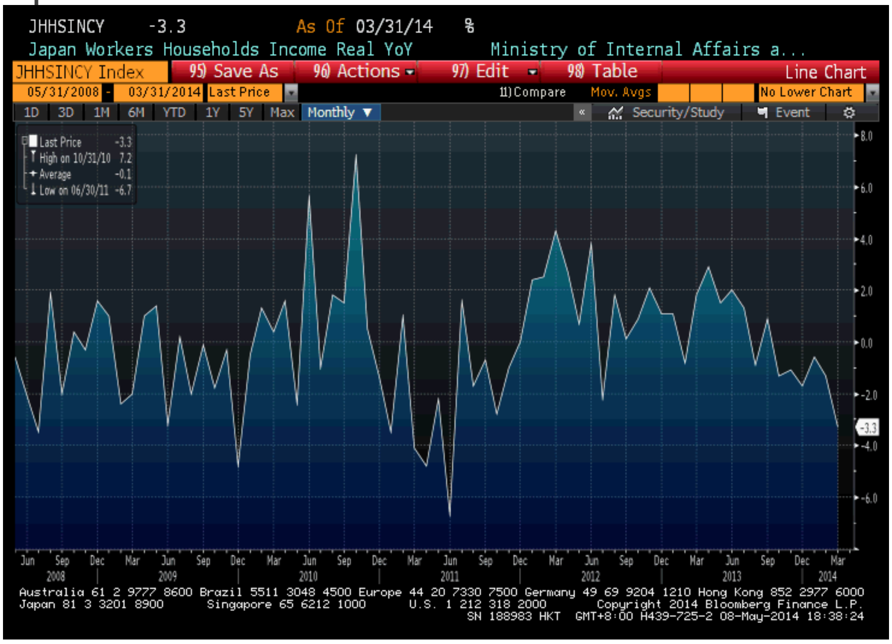
Japan CPI



Sources: Bloomberg

The economic outlook remains not very promising at this moment. The "positive cycle" expected by the Japanese Government has not yet appeared. The Japanese Government wishes that by implementing a quantitative easing, the Japanese yen will have a sharp devaluation and it will provide a stimulus to the economy. With a lower yen and a better economic momentum, it is expected that it will help the companies to have a higher profit. With a better business outlook, the companies will be more willing to increase wages and the labor will be more willing to increase their spending. At last, a "positive cycle" will be formed.

Japan Workers Households Income Real YOY



Sources: Bloomberg

China Economy and Financial Market:

During the Boao Forum on 10 Apr, Prime Minister Li Keqiang has announced that the long-time expected "Mutual Stock Access" would be implemented soon. The program is not exactly the same as what was expected in 2007. The "Access" expected in 2007 was a one-way program. It was just a program allowing Mainland retail investors to invest on stocks listed in HK. The "Access" which will be implemented soon is a two-way program. Apart from allowing Mainland retail investors to invest on stocks listed in HK, it also allows HK investors to invest on stocks listed in Shanghai.

However, we do not think that the "Access" will lead to a significant stimulus to the HK stock market. It is because it is already quite easy for Mainland investors to open a securities account in HK and trade HK stocks. For example, Mainland investors can open the securities account through some securities brokers in HK and China. Thus, for those who are interested to invest on HK stocks, they should have done it already. It is nothing to do with having the "Access" or not. As a result, we do not think that the "Access" will increase any substantial demand for HK stocks.

Another good example for “Buy the Rumor, Sell the Fact”: Hang Seng Index has started to correct after the “Access” was confirmed

Sources: Bloomberg

Economy and Financial Market in Emerging Markets:

Many emerging markets will have their elections this year. For example, India and Brazil will have their election in Apr and Oct this year respectively. The expected “change” in government has pushed up the relevant stock markets recently (though it is highly unlikely that the change in government will bring a tremendous change to the economy immediately).

Starting from Apr, the election has been officially launched in India (the election will last for 5 weeks). The results of the election will determine who will replace Manmohan Singh as the next Prime Minister. At this moment, most investors expect that Narendra Modi will win the election and become the next Prime Minister. Modi is the governor for the western region. During his leadership, the region has experienced a significant economic growth. Besides, he has also significantly improved the efficiency of the local government.

As investors were quite optimistic that the new Prime Minister would significantly improve the economic situation, the Indian stock market had a very outstanding performance in the past few months (up almost 15%; it was totally contradictory to the economic outlook). We think that investors were overly optimistic. It is because we believe that many existing problems in India will not be solved (in a short period of time) by just changing the Prime Minister.

Indian Stock Market

Sources: Bloomberg

Commodities:
Oil Price: The political crisis in Ukraine continued to be the critical factor affecting the short-term oil price. We expect the political situation in Ukraine will remain unstable in the coming short-term future. Therefore, it will continue to have a positive effect on oil price and will support the oil price to continue to hover at the current level. We expect the oil price will trade at between US$100-105 in the next few weeks.

Oil Price

Sources: Bloomberg

However, we expect the oil price will lose its current momentum and correct to below US$100 once the chaos in Ukraine was ended. It is because we expect the fundamentals for the oil market will remain weak in 2014. The global economic growth is still not strong enough to support the oil price to rocket (the oil demand is not sufficient to push up the oil price significantly). We expect the oil price will trade at around US$90-110 most of the time in 2014.

Gold Price: The gold price has not changed much in Apr. It remained at the level of around US$1,300 most of the time in Apr. We believe that the positive effect from the political uncertainty in Ukraine has already been diminishing. It is because investors are well aware that the political crisis in Ukraine will not lead to any serious conflict between US, EU and Russia. Thus, even though the tension in Ukraine may be heat up (like last week), the positive effect on the gold price will only be temporary. Therefore, we believe that even if the political situation in Ukraine has worsened again in the future, it will not lead to any tremendous support to the gold price. We expect in the coming weeks, the gold price will consolidate at the current level. Besides, we remain our belief that the downside risk is still bigger that the upside potential (at the existing price of US$1,300).

Gold Price

Sources: Bloomberg

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

Important Note & Disclaimer:

For any comments, please send email to us at enquiries@amgwealth.com.

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