AMG Market Commentary

**April 2015**

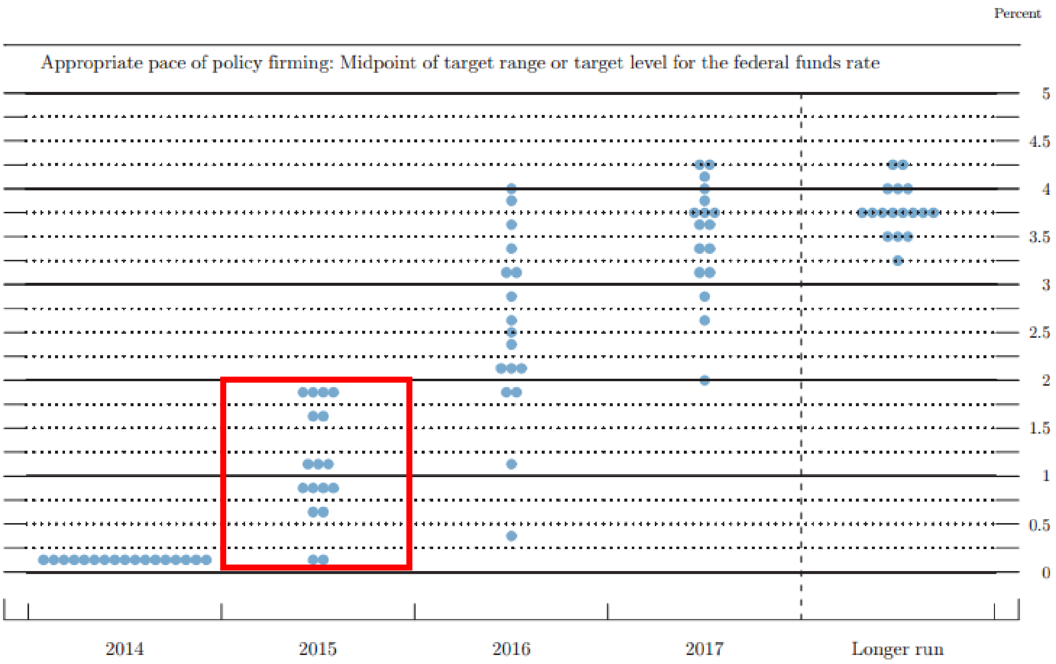
## Three Influential Factors to 2015 Stock Market

The following three factors will substantially influence the stock market in 2015.

### 1. Monetary Policies from Global Central Banks

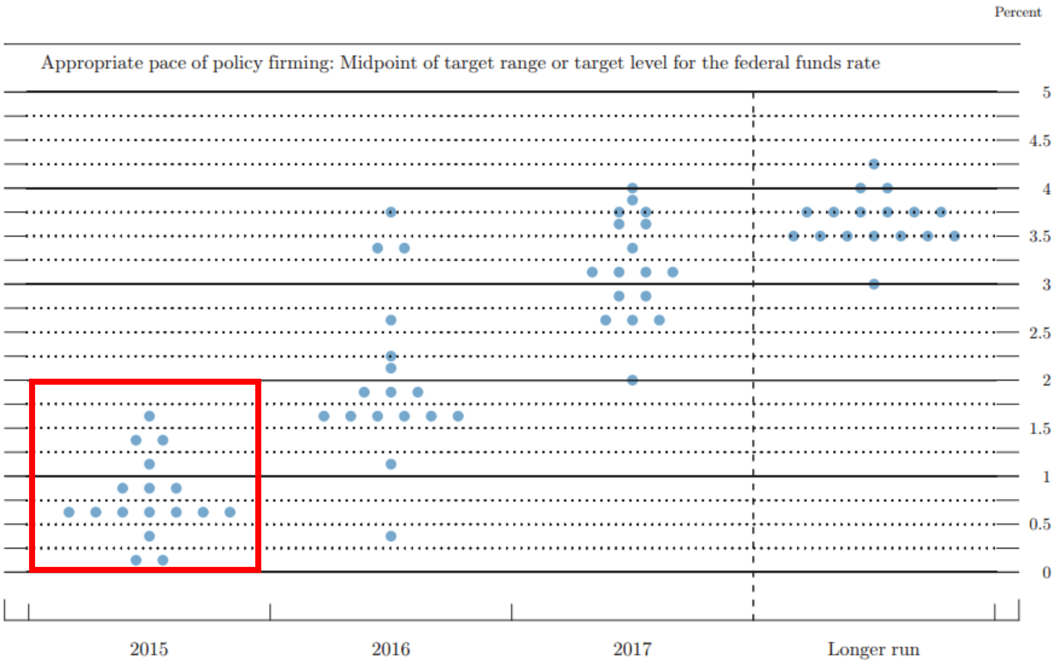
Even though the US Fed is almost ready to kick up its target interest rate, we expect the speed and the scale of the increase will be moderate in 2015. In the following one year, the interest rate will still be relatively low even if the raise starts. It is because the interest will still be significantly below the historical average even if the target interest rate is increased to 1 %. Therefore, nudging up interest rate will not lead to any substantial impact to the US economy. During the start of the interest rate hike, it may lead to a short-term volatility to the financial market. However, we don't think it will bring long-term adverse impact to the stock market. History has shown us clearly that as long as the nudging-up is driven by economic recovery (rather than by inflation pressure), the interest rate increase will do much more good than harm to the stock market (because the central bank will only dare to increase the interest rate when it has enough confidence on the economic growth outlook).

Interest Rate Projections by US Federal Reserve officials during FOMC Meeting in December 2014



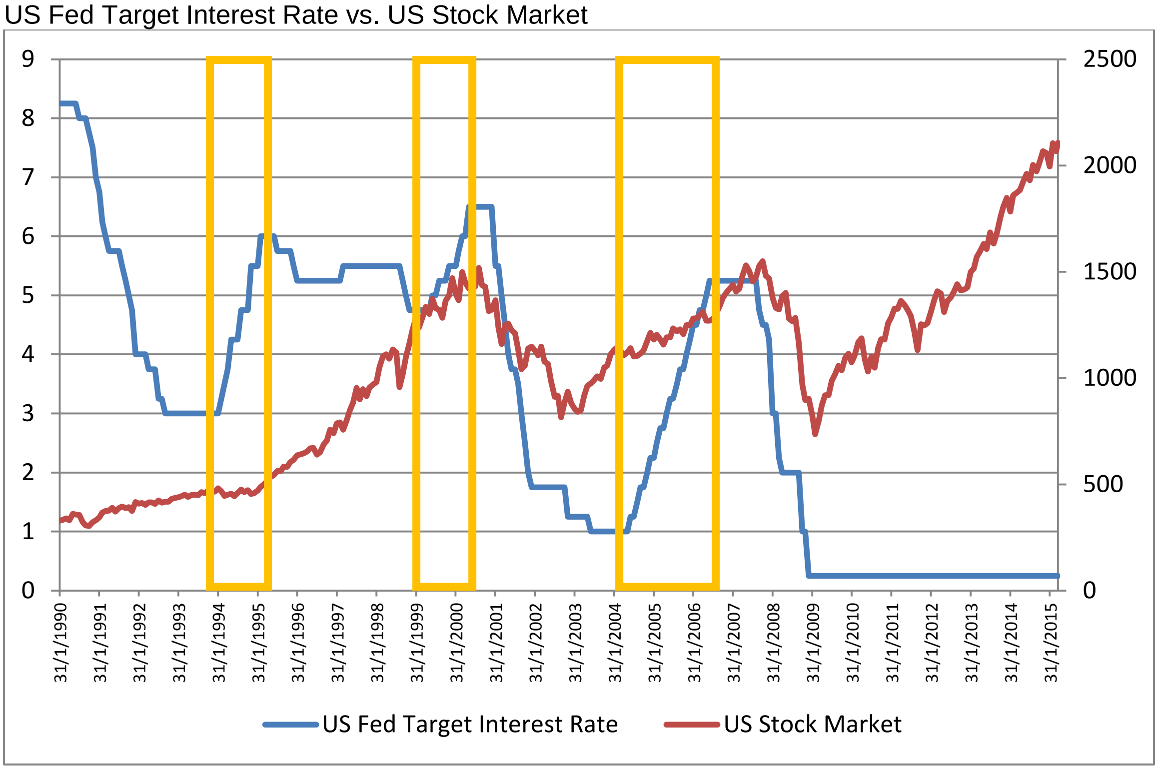

***Sources: US Federal Reserve***

Interest Rate Projections by US Federal Reserve officials during FOMC Meeting in March 2015 (Compared with the meeting in Dec 2014, the officials have adjusted down the interest the rate projections for 2015 and years following)




***Sources: US Federal Reserve***

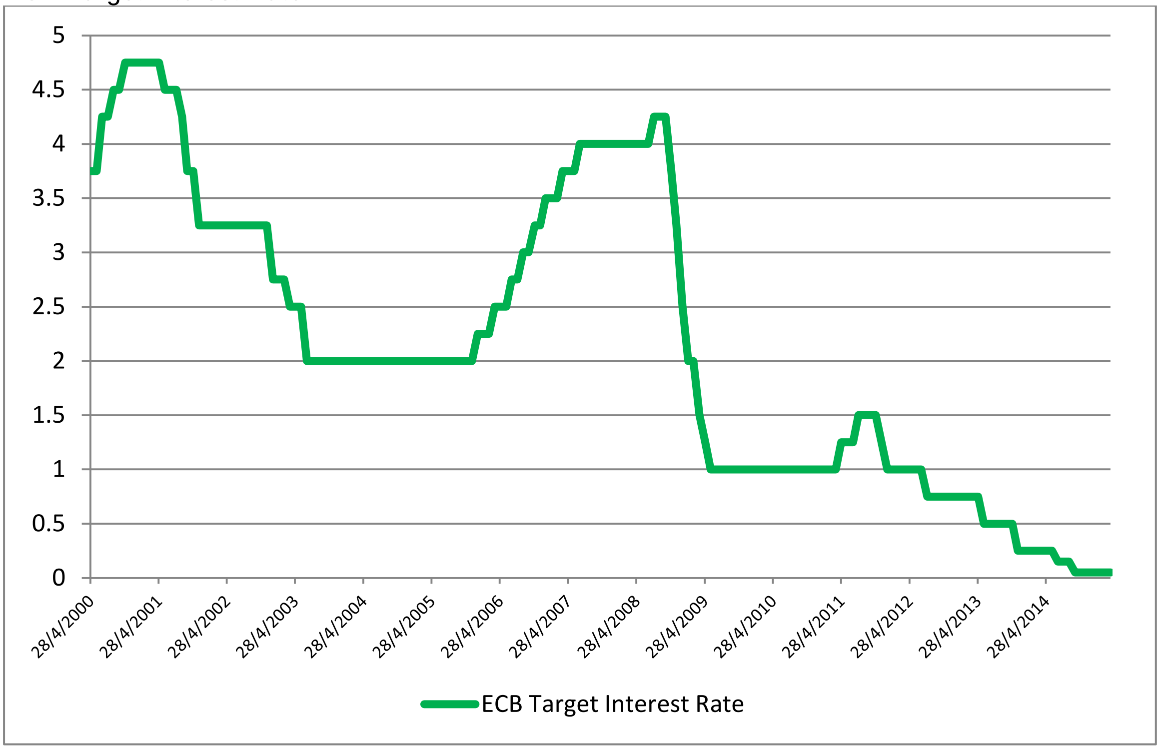
US Fed Target Interest Rate vs. US Stock Market




***Sources: Bloomberg***

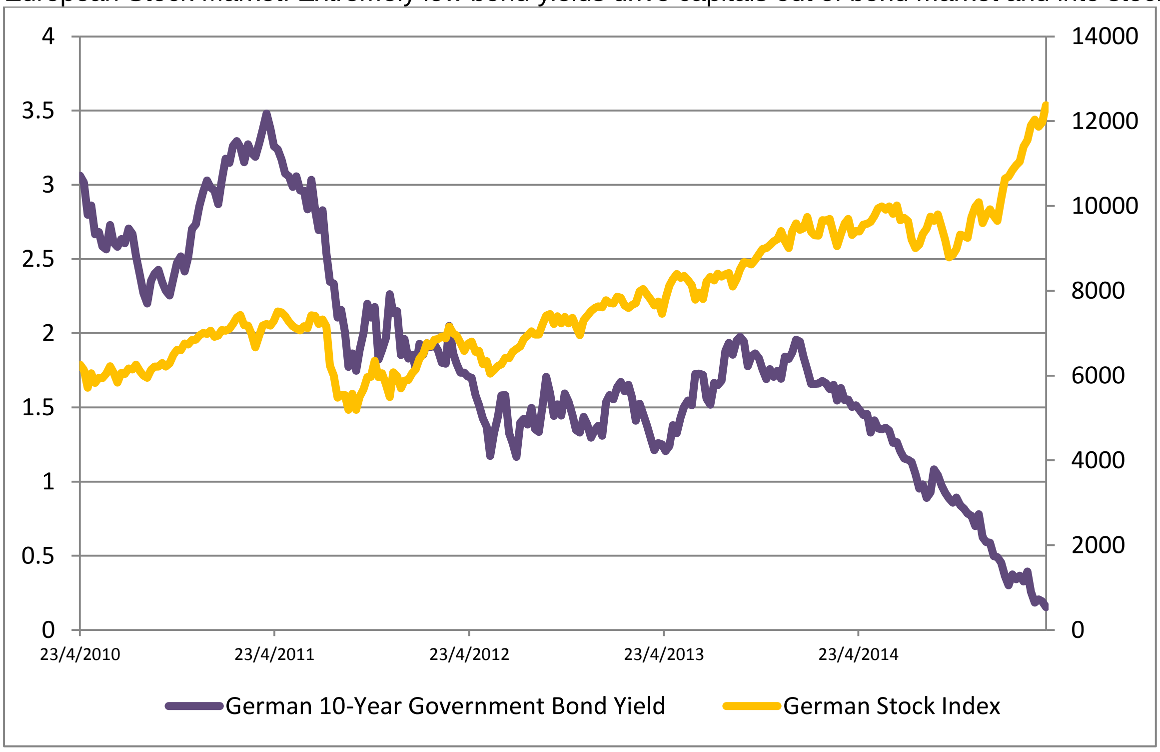
In fact, except the US, no major economic powers in the world will tighten its monetary policies in 2015. On the contrary, most major countries and regions, such as Eurozone, China and Japan, are expected to maintain, if not expand, their current level of fiscal and monetary easing in order to stimulate their economic growth. For example, the European Central Bank (ECB) has not only decreased its target interest rate to almost zero (and even imposed negative interest rate on deposits in ECB) and launched another round of TLTRO to increase the liquidity in the banking sector, but also, following the US Fed, officially begun to purchase government bonds from the secondary market. Starting from March 2015, the ECB will buy €60 billion of government and corporate bonds every month at least till September 2016. Apart from the ECB, the Bank of Japan (BOJ) and the People's Bank of China (PBOC) has also tried to boost up its economy by implementing easing monetary policies. Although the BOJ has maintained its easing monetary policy unchanged in the past few months, its annual monetary supply of ¥80 trillion has already been the record high in the Japanese economic history. For China, it has become more and more certain that it will join the “party” for global easing. Even though it doesn’t necessarily mean that the Chinese government will dramatically change its policies within a very short period of time, indeed, the policy has already gradually changed from tightening to easing. For instance, in the past half year, the Chinese government has adjusted down the required reserve rate (RRR) once and decreased the interest rate twice, which was rarely seen in the past few years (easing policies in China also include lifting the restrictions on house purchasing quota and allowing more lending to finance property purchase, adding liquidities into the banking system, and providing more money supply to the market through different financial tools).

ECB Target Interest Rate



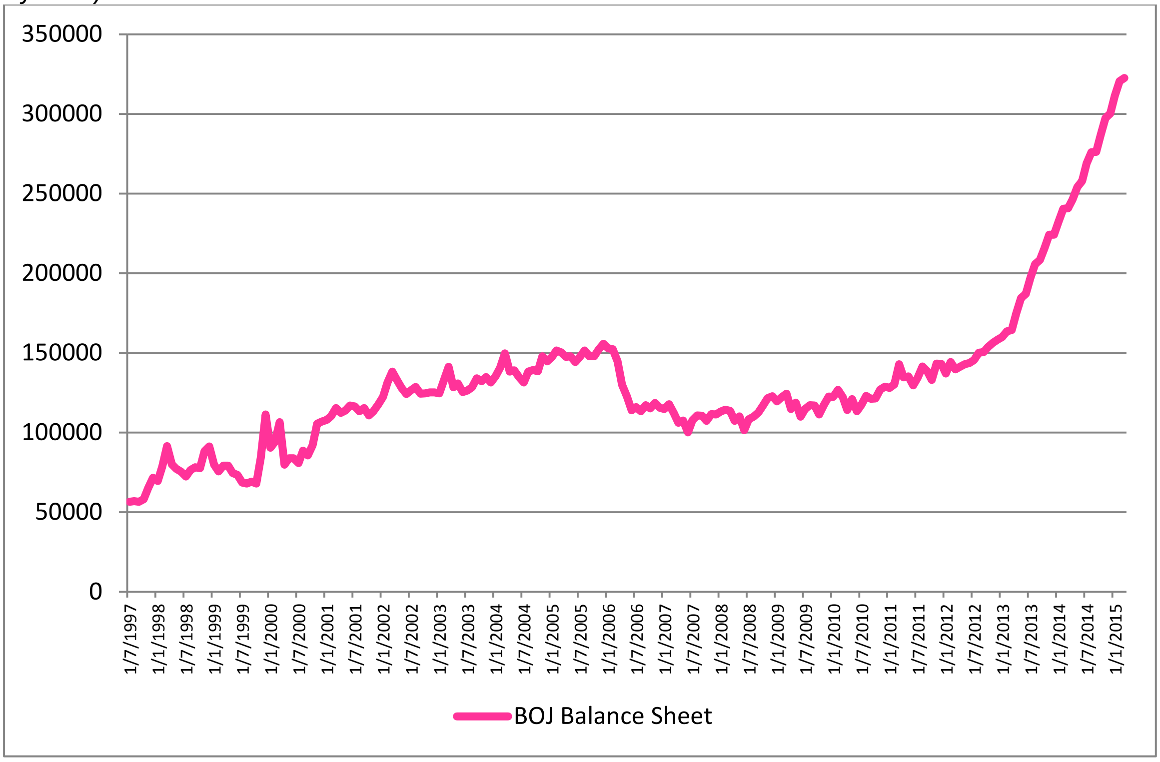

***Sources: Bloomberg***

European Stock Market: Extremely low bond yields drive capitals out of bond market and into stock market.



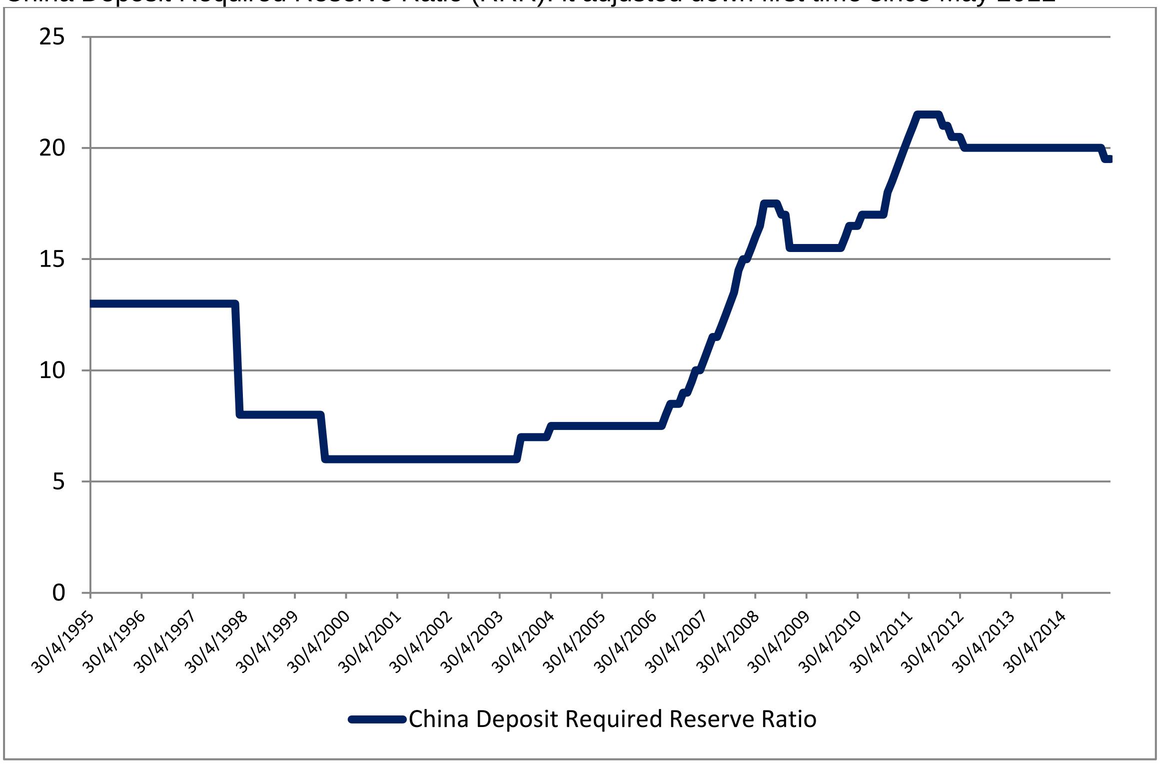

***Sources: Bloomberg***

BOJ Balance Sheet: BOJ has increased its money supply by more than ¥150 trillion since 2013 when Abe start his term. Money supply by BOJ has been doubled in only two years. (Before then, it took BOJ six years to increase it by 50%)



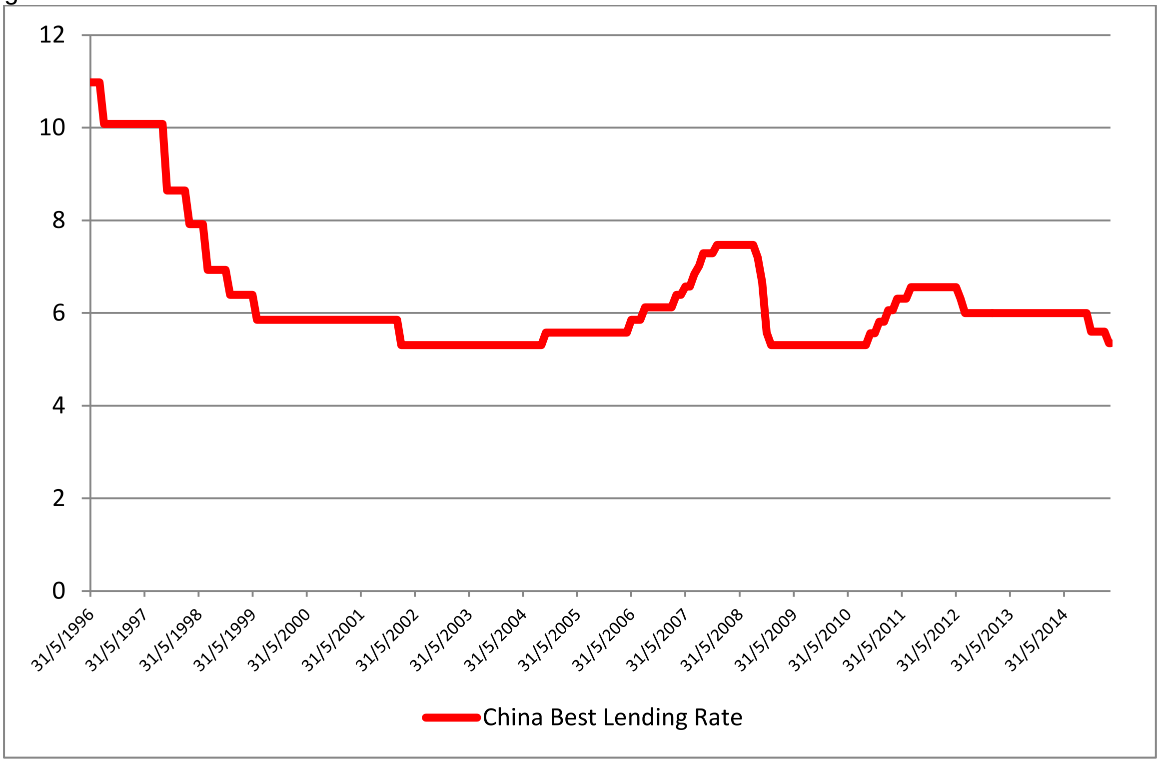

***Sources: Bloomberg***

China Deposit Required Reserve Ratio (RRR): it adjusted down first time since May 2012




***Sources: Bloomberg***

China 1-Y Best Lending Rate: it has been cut twice in the past half year, which had never happened since the global financial crisis in 2008




***Sources: Bloomberg***

## 2. Global Economic Growth

Compared with 2014, the economic growth in 2015 may be slower mainly because some markets including Eurozone, Japan, China, and other emerging markets are more or less facing different economic uncertainties.

Eurozone: First of all, the Eurozone economy is still struggling from recovering from recession. Hazed by previous debt crisis, many Eurozone countries have had to push tightening fiscal policy, which lead to a negative impact to the economic growth. Fortunately, after years of fiscal tightening, the fiscal situation of most Eurozone government has substantially improved and the tightening policy could be relaxed a little bit (which in return could reduce the adverse impact it has imposed on the economy). On the other hand, ECB has dumped its conservative image and launched super quantitative easing to stimulate the economic growth. Therefore, we believe Eurozone economy won't perform too badly, if not good.

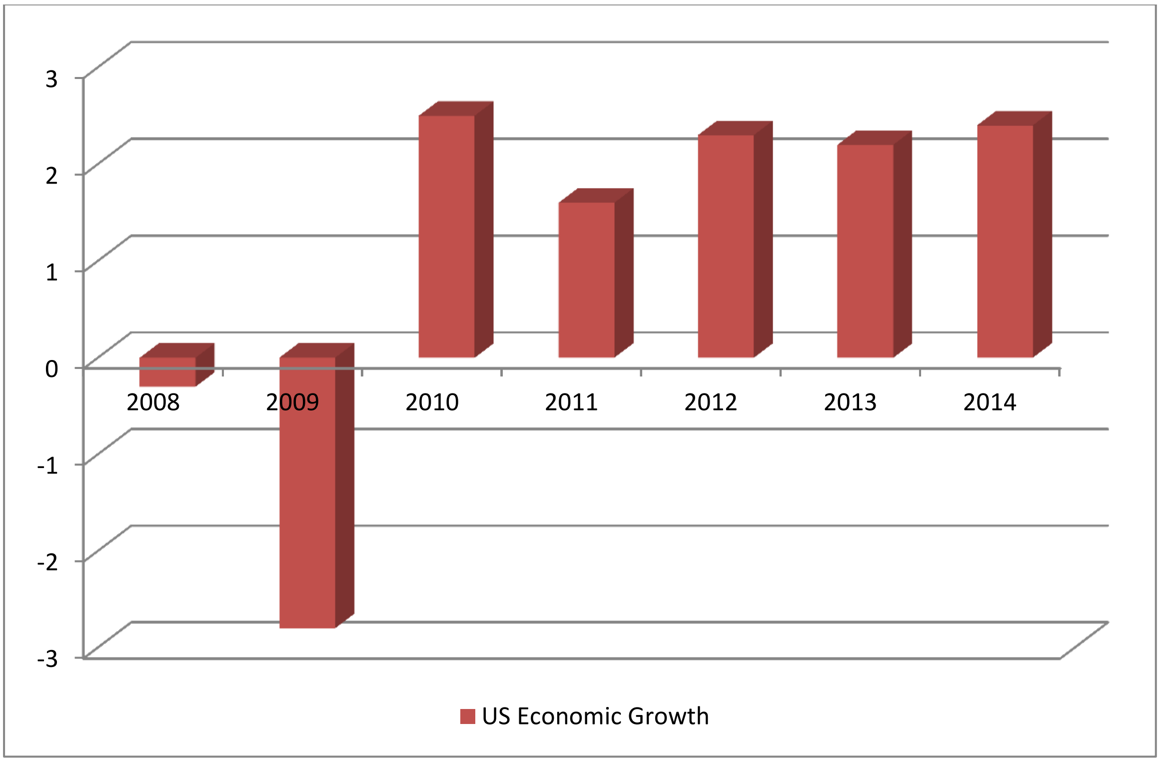
Japan: Compared with the Eurozone, Japan's economic outlook is more obscure. Because weak yen (only helping to push the stock market up) doesn't increase the confidence for investment nor consumptions. It is especially true for the Japanese consumers. Consumption confidence continues to remain low as there is no sustainable increase on salaries (the income may increase but mainly in special bonus rather than monthly salary increases).

China: Short-term economic problems aren't as severe compared with Europe and Japan. China's short-term economic problems are mainly caused by the negative effects from the economic restructure. In the past few years, the Chinese government has been determined to change the economic structure that has been overly dependent on low-tech exports, property market and government investments on infrastructures.  In order to diversify the economic structure, it supports the development of high-value-added manufacturing sector, and stimulates domestic consumptions. Even though these policies are favour to the long-term economic growth, short-term economic growth has to be compromised. Thus, as long as the Chinese government is willing to slow down the speed of economic restructure, the short-term difficulties that China is facing will be solved. Of course, it in return will lead to long-term economic problems.

Other Emerging Market Countries: The Russian economy is struck by the political and economic collisions with Western countries. Market expects Russian to suffer 3-5% economic drawdown in 2015. Brazil, another major emerging market country, will continue to suffer economic slowdown in 2015. The outlook is quite obscure due to the low efficiency of the government and the spending on the World Cup and the Olympic Games was too excessive and thus the government doesn't input enough resources to develop the local economy. It is expected that the Brazil's GDP might decline 1% in 2015.

US: The United States has become the backbone of global economy. In the past few years, the economic growth in US has been quite stable, though not startling. In 2015, we expect US economy to expend 2.5-3%. This growth rate will not only benefit other economies, but also help the global economic growth.

US Economic Growth




***Sources: Bloomberg***

Economic Growth Forecast for 2015

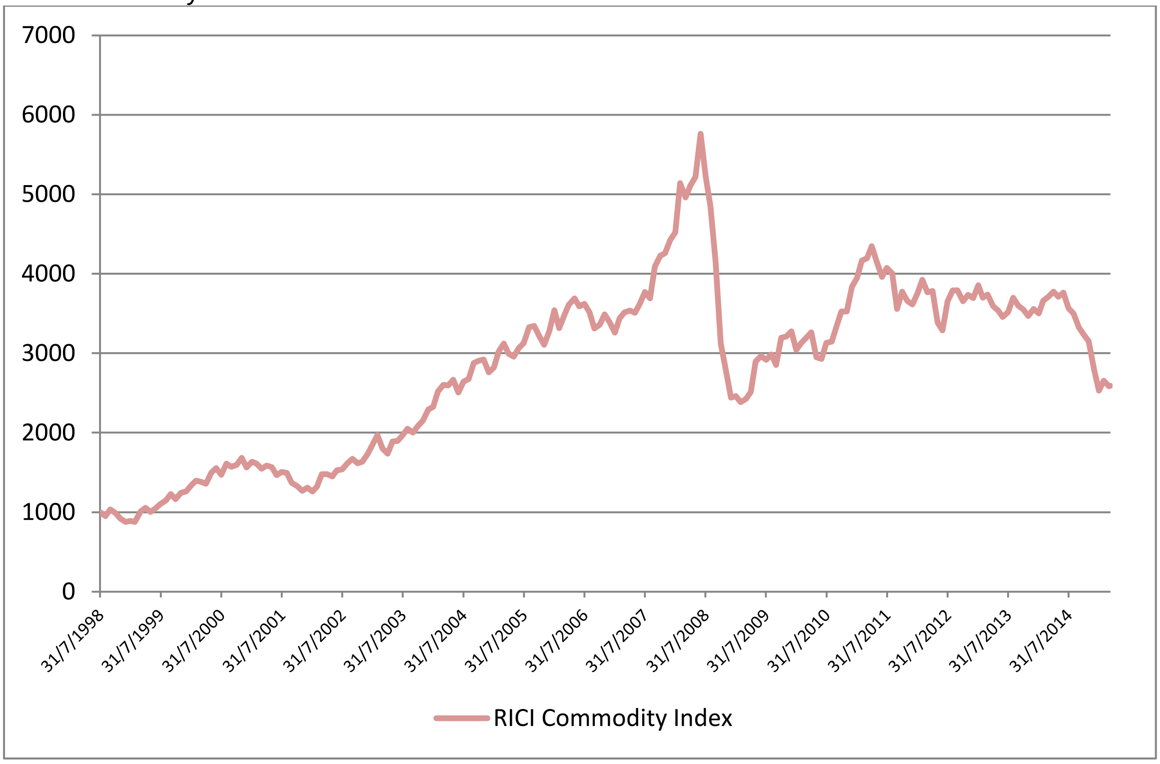
| Global | G10 | Europe | Asia | Latin America | US | Euro Zone | Japan | UK | Canada | Australia | Germany | France | China | Russia | Brazil |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 2.7 | 2.1 | 1.6 | 6.3 | 0.7 | 2.9 | 1.3 | 1 | 2.6 | 2 | 2.4 | 1.6 | 0.9 | 7 | -4 | -1 |

***Sources: Bloomberg***

## 3. Commodity Prices Plunge

There are two main reasons behind the global commodity prices plunge in the past half year. First, the US dollar surge weighted down the commodity prices which are usually quoted in dollars. Because for non-dollar investors, the dollar appreciation will push up the commodity price (if exchanged to other currencies), and therefore the demand for commodities is decreased. Second, investors worry that the sluggish global economic growth will drag down global demand for commodities.

RICI Commodity Index




***Sources: Bloomberg***

No matter what the reasons are, commodity prices plunge will in the medium-to-long-term stimulate the global economic growth. Even though the price drop affects the economic growth of the commodity exporting countries, it benefits the economic growth of the commodity importing countries. In sum, the relatively low commodity price will increase consumers' dispensable income and lower down the cost for production, both of which will stimulate consumptions and boost up the global economic growth. These factors are especially significant to those major energy consumption countries and regions, such as the US, Eurozone, Japan, and China.

In conclusion, we believe the 2015 stock market will continue the upward trend (the fundamentals are strong enough to offset the negative factors such as interest rate increase in the US, and economic recession in some emerging countries).

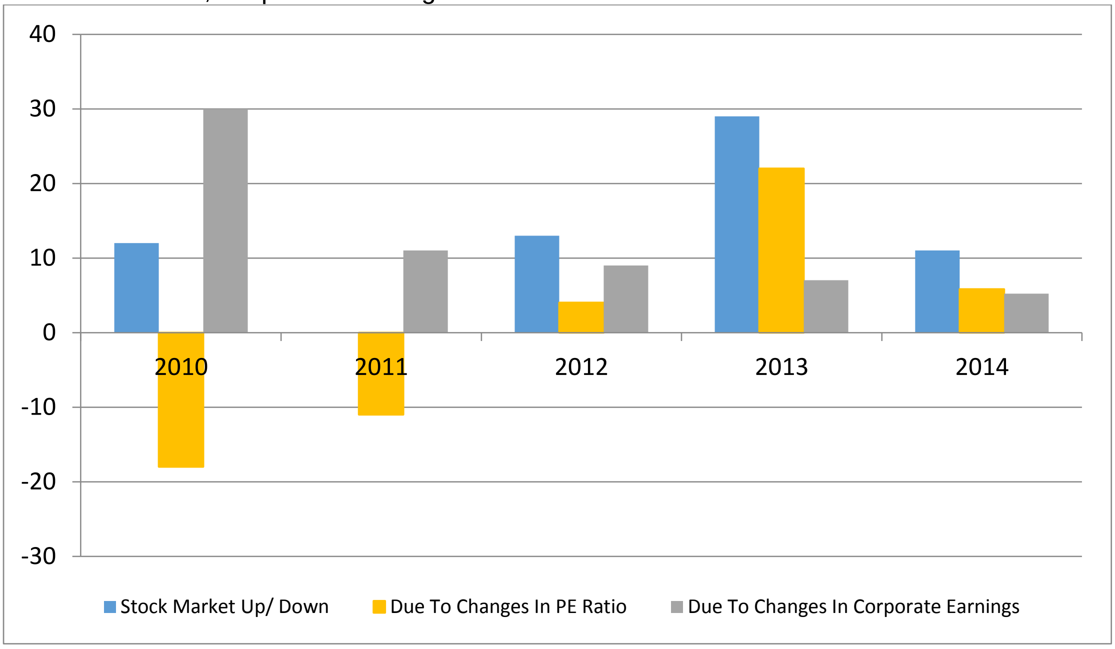
## Market Overview and Outlook

### US Economy and Financial Market

The momentums for US economic growth show signs of slowdown in Q1 2015. A series of economic data have reflected that the economic momentums in Q1 2015 aren't as strong as in 2014. However, we don't think investors need to worry too much about this as the weak data are more likely caused by the short-term economic fluctuations rather than a drop from the peak. It is expected that the Q1 economic growth will only be 1.5-2%. However, we are quite confident that the US economy will resume stronger momentums in the next 2-3 quarters and the GDP growth rate will be around 2-2.5% in 2015 whole year.

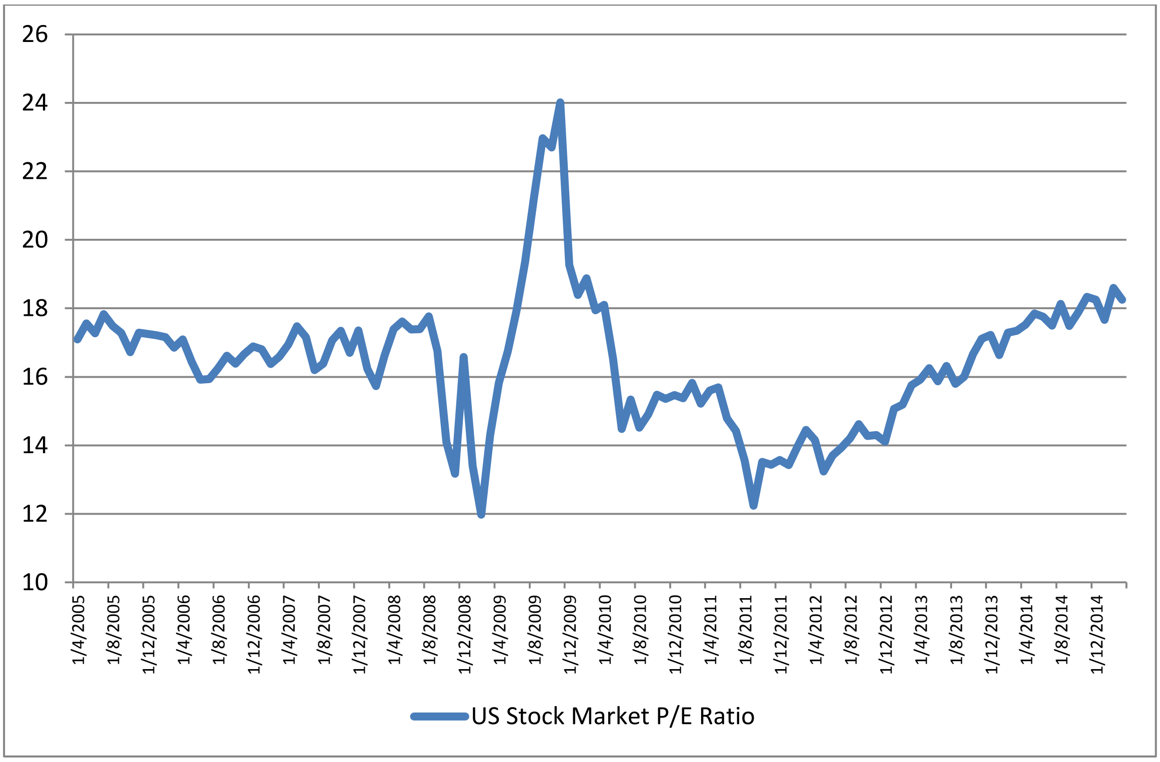
The stock market performance in the first quarter has been far from astonishing. It is just consolidating at the high level and is not able to mark any further breakthrough. It is mainly because of two reasons. First, investors still worry about the possible earlier than expected interest rate increase by the US Fed and therefore the stock market is under pressure. A more important reason is that after years of stock rally, the current P/E ratio is relatively high as the growth of corporate earnings hasn't come up with the rise of the stock market. Thus, the further room for the stock market to keep surging up is not that big. For example, the current P/E ratio for S&P500 is 18.5x. The valuation is definitely not cheap even though it's not as high as a stock-market bubble level.

US Stock Market, Corporate Earnings and P/E Ratio




***Sources: Bloomberg***

US Stock Market P/E Ratio



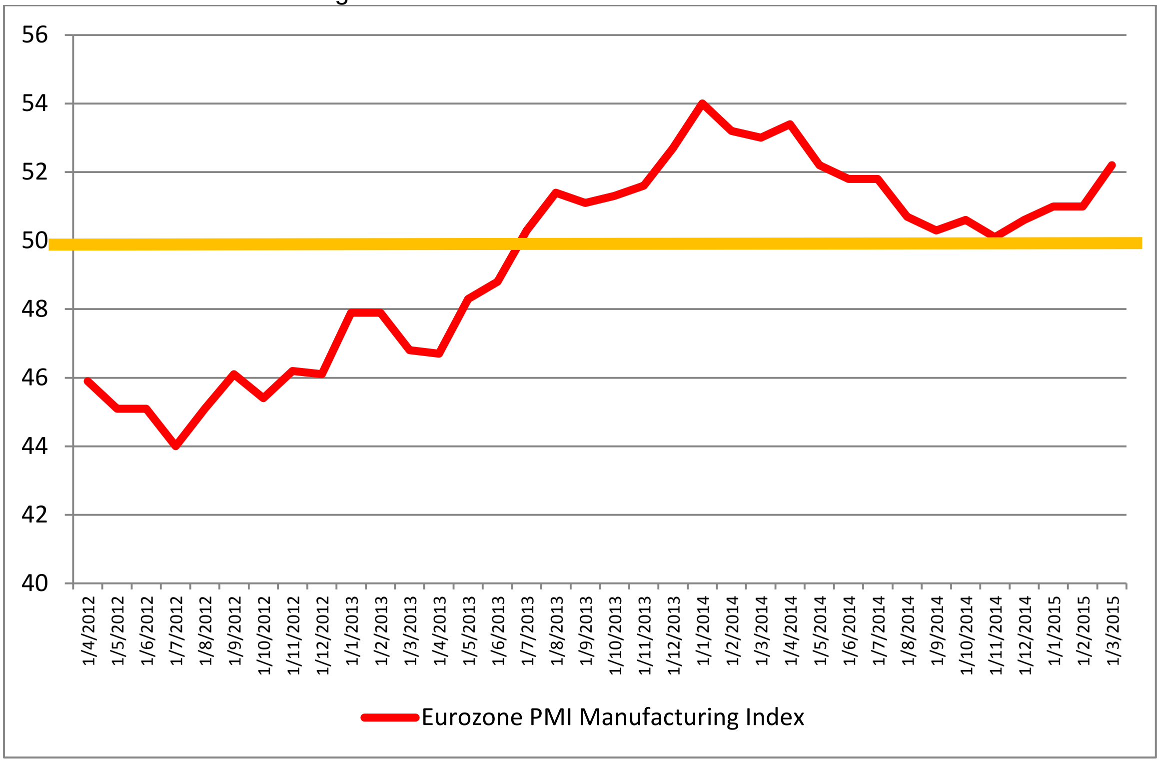

***Sources: Bloomberg***

The US Federal Reserve will for sure increase its target interest rate this year. Our forecast is that the Fed will nudge it up to 0.5% by the end of 2015. The number is smaller and the speed is slower than market expectation back to the beginning of this year. The main reason is that the Fed does not have any need to accelerate the interest rate raise. Even though the US economy, especially the labor market, has substantially recovered, and the economic conditions are strong enough to allow the Fed to increase the interest rate, the CPI is still remaining low, which means the Fed is not in urgent to increase the interest rate to prevent inflation.

**Eurozone Economy and Financial Market**

Since the start of this year, it appears that the Eurozone economy has started to recover. Even though it is still too early to determine whether the good sign will sustain, a good start is always welcomed. We believe the recent recovery is mainly related to the former quantitative easing from the EBC. In the past one year, ECB has been continuously launching easing monetary policies to stimulate the economy. Those policies include interest rate cut, adding liquidities to banks, bond purchase directly from market to press down bond yields, etc. It is hoped that the above actions will support the domestic consumptions and investments.

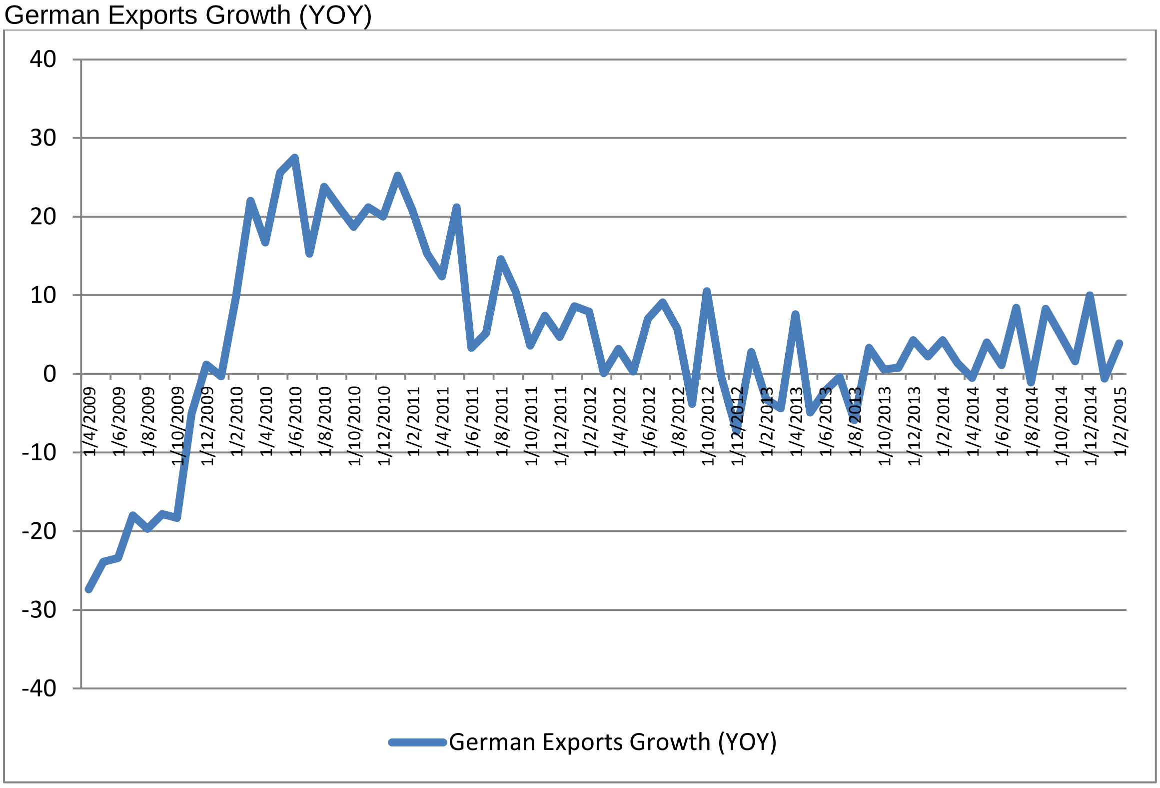
Eurozone PMI Manufacturing Index




***Sources: Bloomberg***

On the other hand, the depreciation of euro helps Eurozone countries to increase exports. German exports have obviously been benefitted by the weak euro. Last year, the German exports increased by 3.8%, this helps to drive up the economic growth by 1.6% in 2014. We expect that Germany could sustain such decemt economic growth in 2015. It is much better than growth rate in 2012 and 2013, which is less than 1%.

German Exports Growth (YOY)




***Sources: Bloomberg***

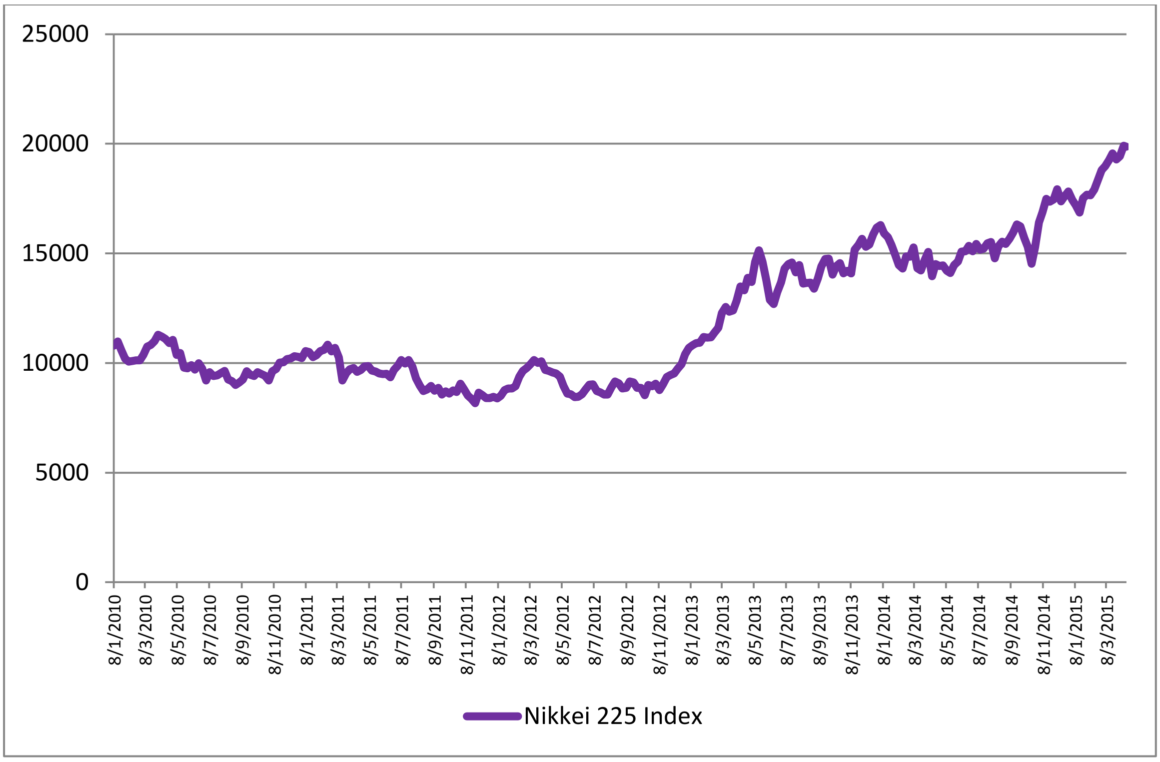
In 2015, the European stock market has been continuously driven up by the ECB's QE. It is because the QE has pressed down bond yield, and forced some investors to reallocate money from bond market to stock market, and increased the demand for stocks. Since the beginning of 2015, the German stock market has been up 24%, and the European stock market has been up 20%.

**Japan Economic and Financial Market**

Compared with Eurozone, BOJ has implemented QE for more than two years. According to the reported economic figures in the past two years, the monetary easing hasn't brought any significantly economic recovery to Japan. In the past two years, the Japanese economy has been quite unstable. The main reason is that the Japanese economy has been sluggish for twenty to thirty years. The problem that Japan is facing is far more complex than short-term economic cycles. Monetary easing alone couldn't possibly solve structural problems. For instance, due to the long-term hardship from the deflation and economic stagnation, even though the economy has improved, the price of goods has increased, and the salaries (however, the increase is mainly come from the one-off bonus, rather than the monthly salary increases) has increased in the past year, most corporations or consumers are still lack of confidence to the economic outlook and thus don't dare to increase investments or consumptions. Because of this, the easing monetary policies fail to form a positive economic cycle (economy recovers, corporate earnings grows and salary increases, corporate investment and personal consumption increase, lead to a new round of economic growth).

However, as investors, we don't need to wait for a true recovery of the Japanese economy. During the last two years, the super easing monetary policy from the BOJ has triggered a sharp depreciation of the Japanese yen and brought huge benefits to the Japanese export companies. Weaker yen encourages more exports and increases export revenue and profits (due to a weaker yen, the same amount of US$ revenue and profit will convert into a larger amount of yen). Thus, the Japanese stock market has been driven up by the weak yen. In the past two years, the Nikkei 225 Index has surged up to recently 20,000 from 10,000 in 2013 (although the return will be lower [around 50% only] if we quoted it in terms of US dollar, as the yen has depreciated about half in the past two years). In fact, we have already sold our holdings of Japanese equity fund for profit taking this March. The reason for our action is not because we think that the Japanese stock market has peaked, it is just simply because we think the positive effect of super easing monetary policy on the stock market is substantially reflected in the current stock market price and thus we think we should reallocate the money to another more attractive market.

Nikkei 225 Index

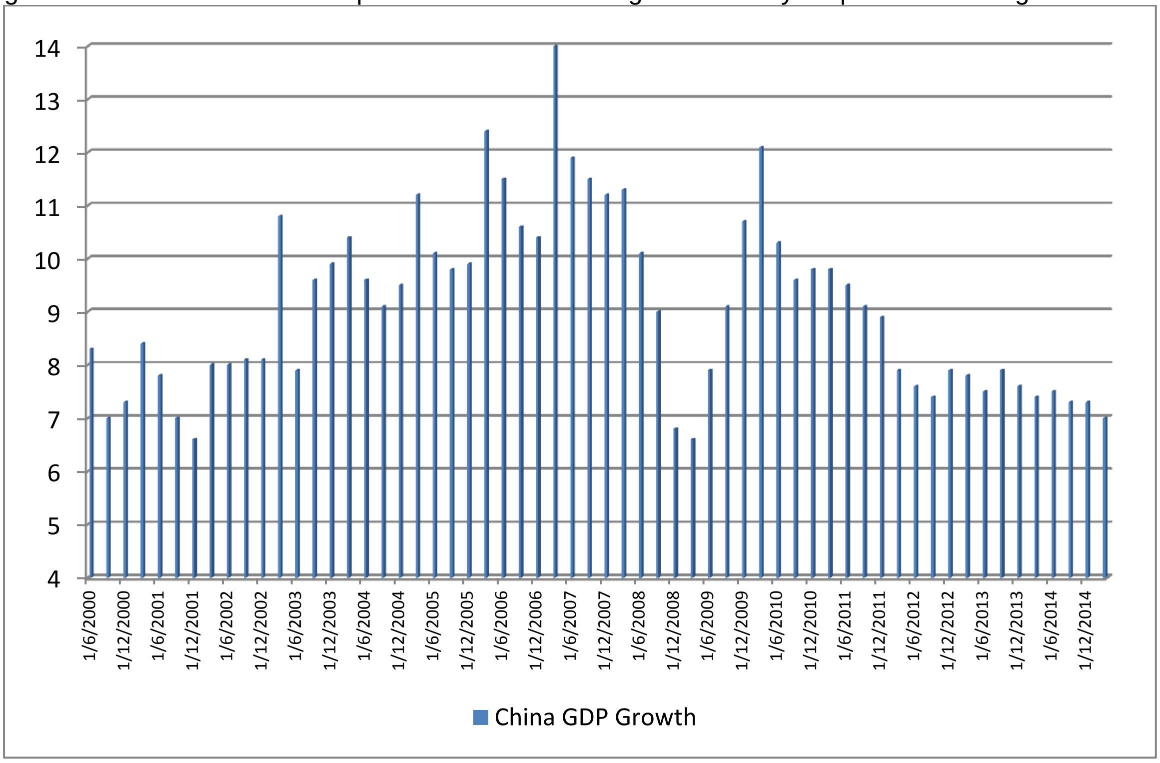



***Sources: Bloomberg***

**Chinese Economy and Financial Market**

There are two main topics about the Chinese economy this year. One is that the Chinese economy will continue to be weak, and probably weaker than expected. The Chinese government might be forced to stimulate the economy. The other is that the expansionary fiscal and monetary policies (from tightening to easing) will continue to become the main supporting factor for the stock market, and it will last for half to one year.

China Economic Growth (YOY): The economic growth for Q1 2015 is only 7%, just reaching the target the government set for 2015. It is possible the economic growth shortly drop below the target.




***Sources: Bloomberg***

First, there are both intrinsic and extrinsic factors behind the economic weakening in the past years. One of the intrinsic factors is that the Chinese government is pushing economic restructure (In the past few years, the Chinese government has been determined to change the economic structure that has been overly dependent on low-tech exports, property market and government investments on infrastructures.  In order to diversify the economic structure, it supports the development of high-value-added manufacturing sector, and stimulate domestic consumptions) and therefore weaken the economic momentums. The other is that to take care of the mess left by the 4 trillion policy, the Chinese government has been pushing tightening monetary policy during 2009-13, which to some extent hit the economy. The extrinsic factor is the negative effect on the Chinese exporting sector from the weak economic growth of Japan and Europe. The depreciation of the Japanese yen and the euro has further put the Chinese exporting sector in disadvantages (as the depreciation of the Japanese yen and euro implies the RMB appreciates against them). As a result, exports failed to drive up the economy as it has been in the last one or two decades. Because the economy is turning weak, the Chinese government has been forced to implement loose fiscal and monetary policies to stimulate the economy.

Second, the easing policies will be continued in 2015. It is because the Chinese government is worried that the economy might turn weak severely if the easing policies have been taken away. In the past six months, the Chinese government has cut the interest rate twice and the required reserve ratio once (easing policies in China also include lifting the restrictions on house purchasing quota and allowing more lending to finance property purchase, adding liquidities into the banking system, and providing more money supply to the market through different financial tools). It becomes obvious that the monetary policy has been changed from tightening to relatively easing. We think the easing policy will become more and more in the coming six months, which will continue to be the major supporting factor for the stock market (as the stock market surge in the past half year is mainly due to the policy change rather than the economic recovery).

Easing Monetary Policy Push Up Stock Market

| | QE Launched | Stock Market Performance 24 months after the QE launch |
|---|---|---|
| US QE1 | Q4 2008 | Up 3% |
| US QE2 | Q4 2010 | Up 31% |
| US QE3 | Q4 2012 | Up 40% |
| Japan | Q1 2013 | Up 73% |
| Eurozone | Q1 2015 | ?? (Up 21% since the beginning of 2015) |
| China | Q4 2014 | ?? (Up 73% since Q4 2014) |

***Sources: Bloomberg***

**Emerging Market Economy and Financial Market**

Quite a few emerging markets are still troubled by economic slowdown and capital outflow. Three of the four major emerging market countries, Brazil, Russia, and China, are suffering sluggish economic growth or even economic recession, though their difficult situations are caused by different reasons. Among them, we think the economic outlook will be more pessimistic in Brazil and Russia as their government (when compare to the Chinese government) have lesser room to stimulate their economy.

Economic Growth Forecast for Emerging Countries

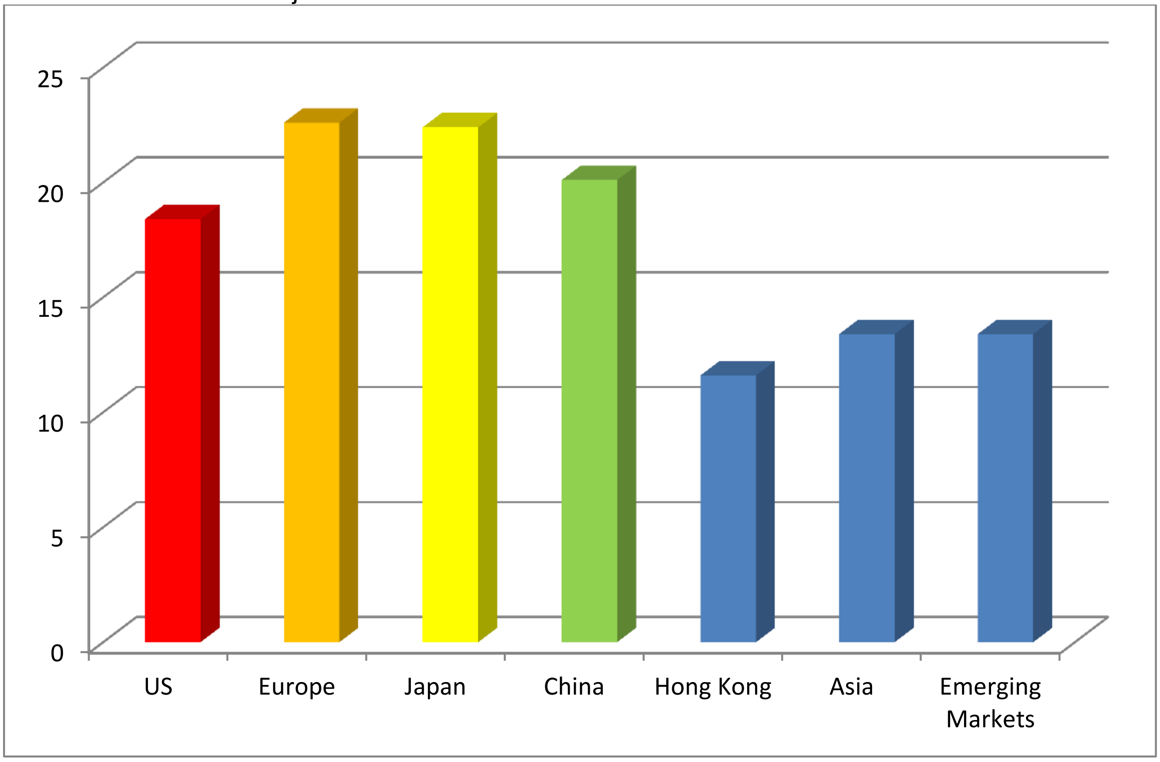
| | **Economic Growth in 2014** | **Economic Growth Forecast for 2015** |
|---|---|---|
| **Asia** | 6.28 | 6.31 |
| **East Europe, Middle East and Africa** | 2.38 | 0.57 |
| **Latin America** | 1.23 | 0.79 |

***Sources: Bloomberg***

Recently, many investors might have concerns that the recent sharp drop in oil price will further weaken the emerging market economies. However, we don't think investors need to worry too much about this. Even though the oil price drop will impose negative effects on Russia, Venezuela, and most of Middle East countries, not all emerging countries are oil producers (to be more precise, not all emerging countries are oil exporters). Oil price drop might affect oil exporting countries significantly. However, it will also bring huge benefits to many emerging markets (for those oil importing countries) as they need huge oil imports. Oil price drop could lower their energy cost, and benefit domestic consumption and exports.

Except the economic slowdown happening in some emerging countries, the emerging market is also affected by the capital outflows. Because investors worry that the financial market might experience turbulence once the US Fed increases its target interest rate, many investors have pull money out of emerging markets and back to developed markets in the past one or two years. Capital outflow has not only affected the economic growth of the emerging markets, it also triggered the depreciation of their currencies, the rise in their bond yields, and the underperformance of their stock markets. We believe the above situation will continue in the short-term future. We expect the situation will improve only after the US Fed started its interest rate hike. It is because at that time, the investors will finally realize that the interest rate increase is not as bad as what they have thought now. Then, the investors will put their money back to risky markets, such as emerging markets.

P/E Ratio For Global Major Stock Market

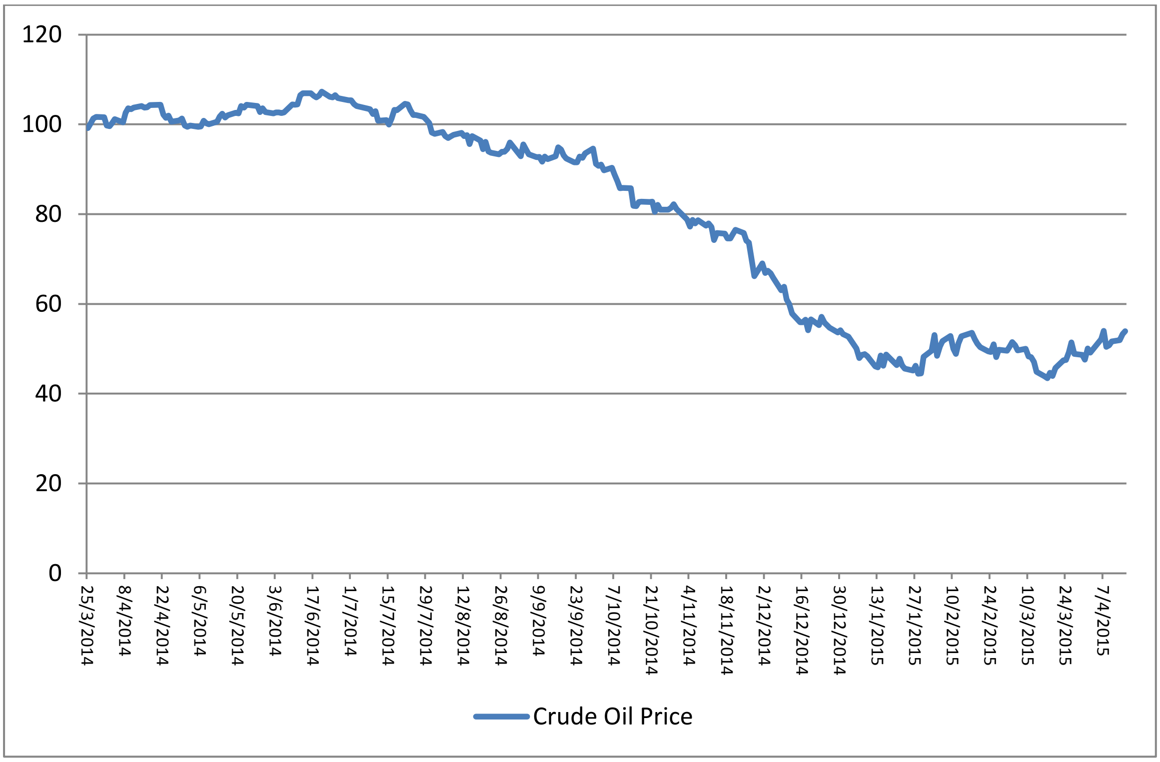



***Sources: Bloomberg***

**<u>Commodity (Oil Price)</u>**

After the sharp drop between August 2014 and January 2015 (the oil price dropped from $100 to the lowest $42), it appears that the oil price has found the bottom (even though the negative factors still exist in the market). We don't know if the oil price has really found the bottom, but the current oil price has been very attractive in a medium-to-long term perspective. In 2015, the oil price might not rebound too much. However, we believe it won't be difficult for the oil price to double in two-three years' time.

Crude Oil Price




***Sources: Bloomberg***

**<u>Commodity (Gold Price)</u>**: Except for a short period in January, the gold price has been wandering around $1,200 since the beginning of 2015. In short-term, the gold price will still be weighed down by the expectations of US interest rate increase. Therefore, even though the gold price retrieves, it's still not easy to breakthrough $1,300, the short-term high recorded in Jan, in the short-term future.

There are many reasons that weaken the gold price in a medium-to-long term perspective. The forces that pushed up gold price in the last decade (since 2003) include prolong depreciation of US dollar, concerns about hyperinflation because of sharp increase in money supply and the fear that the global monetary system may be collapsed due to ultra-loose monetary policy by global central banks. Now we can see the concerns were either haven't happened (and seem not going to happen in the short-term future) or has been changing. First, the dollar depreciation started in 2003 has officially ended in 2014. The dollar index has surged nearly 25% since the August 2014. It is expected that the US$ will continue its rebound in the short term. Second, when global central banks were pushing super QE to save their economies after the financial crisis in 2008, it was quite reasonable for investors to worry about inflation problems. However, the financial crisis has passed for more than six years and the global inflation is still very moderate and is well under control. In contrast, the global inflation has declined substantially recently due to the sharp drop of commodity prices (some countries may even suffer a short-term deflation). Last but not least, the global monetary system is still believed by most investors even though the central banks around the world have substantially increased the money supply in the past years (at least we haven't seen many investors using physical products, such as gold to replace money for wealth accumulation).

Gold Price


***Sources: Bloomberg***

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



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 9531 Facsimile: (852) 3426 2650