AMG Market Commentary

December 2009

Transitions in growth engine

Government power won over market forces in 2009. Relentless rescue efforts helped to bring back the global financial system and economy from the edge of disastrous damage. For investors, the year started with disappointment but turned into a surprise. And what can we expect for next year?

In 2010, corporate spending and private consumption shall be more important forces to propel the economic growth while government stimulus is expected to fade out. But, the pace and strength of pick up in private sector remain a big question. Whether it will be strong and quick enough to make up for the decline in government spending is a major concern for investors.

Fortunately, the governments showed that they are very prudent in their exit strategy. All of them are emphasizing the area that need more help rather than boasting about the area that recovered relatively quickly. For example, China is working on boosting exports and U.S. pledges to help job market and increasing bank credits. We can expect the government will carefully adjust their exit plans to ensure the economy will return to genuine growth.

Gradual and cautious policy stance means that high unemployment and low inflation shall help to keep interest rates in U.S. and Europe at historical low in the next 2 quarters. In other words, liquidity conditions will still be loose and return of holding cash very low. Market environment will be favourable for risky assets.

As for the investment strategy, our preference is still with stock as an asset class. And the high grade government bonds are less preferred category. For the selection of geographical regions, priority should be given to area with stronger growth such as Asia (excluding Japan) and resources exporters like Brazil, Russia and Australia.

US : Positive

Investors expect interest rate hike to come sooner rather than later as economic data beat estimates. In turn, it helped to lift the USD. Still, the Fed is gauging the suitable level of policy rate with reference to unemployment, inflation and inflation expectations. All 3 factors indicate that low interest is need now and will remain so for some time. So, USD still lacked fundamental support to enter a rising trend.

Europe : Positive

Economic condition in Europe is mixed. Greece and Portugal have their credit ratings or prospect cut by rating agencies due to mounting government debt and inability to control the deficit problem. But, on the other hand, Germany is showing more signs for improvements. An example is the ZEW business sentiment indicator, a leading indicator for German business activity reach 11 month high last month.

China : Positive
Chinese government put down the direction for economic policy for 2010 in the central economic meetings. In the coming year, China will go for more balanced growth and lower reliance on foreign demand. Policy focus will shift to encouraging exports and domestic consumption and on the hand, loan growth and government led investments will be curbed. Divergence in policy target for different sector could lead to divergence in stock performance. For mutual fund investors, skills in stock picking should be more important factor for selection of fund manager in 2010. Stock market in Hong Kong was affected by outflow of capital, and it done poorly recently. Fortunately, there was no sign for full retreat from stock markets as U.S. and European markets are still doing well. It seemed that investors are moving away from emerging markets rather than making full retreat from risky assets. For Hong Kong market, it is expected to turn up again next year when capital comes back.

Emerging markets Korea : Positive
Korean stock market also went up with strong dollar. Weeks ago, the pressure for Korean Won to appreciate was dampening stock market performance. Recently, the pressure on Won and Korean stock market was eased with dollar turning up. So, KOPSI climbed together with NIKKEI. But, a major difference between Korea and Japan is that Korean economy is recovering strongly. It makes Korea much more attractive investment market than Japan.

Commodities : Positive
Stronger dollar weighed on gold prices. Investors are stunning gold for cash. Still, as mentioned before the USD lacked the fundamental support to enter an uptrend. Thereby, the pressure on gold price will go and currently the support level for gold price is at USD 1,000-1,030 per ounce.
Crude oil also retreated a lot. Besides the rebound of the greenback, high inventories were another cause for oil price to decline. For us, we still look for strong support at around USD 65-70/barrel.

Hedge Fund : Neutral
Hedge fund performance for November is generally satisfactory. Barclay Hedge Fund Index was up by 1.39% and YTD performance rose to 21.52% so far in 2009.

Government Bonds : Negative
Bond yields for U.S., UK and major European countries are still at very low level by historical standard while investors are facing the risk of higher inflation and interest rate lifts in 2010. Given the low return and increase yield, they are unattractive holdings.

Things to Look Forward :
Good economic figures are lending support to USD. Poor data for last year means that the figures for coming months shall be satisfactory due to base effect. Thereby, the rebound in USD may still have some way to go. However, we do not see a widespread exit from risky assets and capital shall turnaround in Jan 2010 when investors start to put their money back to work for next year.

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

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