AMG Market Commentary

March 2010

India is in exit mode

After the financial tsunami, there is a saying about a world of two economies. India is the latest example to show how emerging countries are leading in the road to recovery and policy normalization. After lifting cash reserve ratio for banks by 0.75% in February, the Reserve Bank of India took another step to raise the repo rate from record low 4.75% to 5% this month.

The reason behind the interest rate move was that wholesale price index, the benchmark for inflation in India, climbed to 9.89% in Feb 2010. It was by far higher than the government estimate of 6.5%. So, the Indian central bank wanted to make an early move to tame inflation expectations. However, the cause for Indian inflation is that poor harvest last year resulted in surging food prices. Lifting interest rate would not help as food demand is insensitive to price change. The Indian government will probably need to wait till the base effect to kick in and bring down inflation pressure in the middle of the year.

For the Indian economy, gradual interest rate hike would be a better option compare with letting the inflation pressure rise. Strong industrial production and service sector output has already brought the economic back to very strong growth. And the current interest rate at 5% was still quite low compare with the average interest rate of 9% and average inflation of 5% for the last 10 years. So, the impact on consumption and investment should only be very limited.

And for the stock market, interest rate hike is not really news. Rumors about interest rate hike and higher inflation have been there for months. The Bombay SEXSEN Index has been range bounded between 15,000-18,000 for the last 7 months. So, it did not really fall when the rate hike was announced on 19 Mar 2010. It seems to us that investors should really think if fear about interest rate hike is rational.

US : Positive

U.S. economic conditions continued to improve, except for the housing market. In recent months, existing homes and new homes sales both declined as the first round of home buyer credits ended in Nov 2009. It showed that government support is still very important to keep housing market stable. While the good news is, figures for the other areas such as non-farm payrolls, retail sales, consumer credits, and purchasing manager indices also showed improvements. As a whole, U.S. economy is getting better when compared with a few months ago.

Europe : Positive

Eurozone members failed to agree on a rescue plan to help Greece. Despite the agreement to offer financials when needed in the finance ministers meeting last month, Germany now want IMF to step in. The standstill over the rescue plan not just added to the trouble for Greek government, but it also weighs on Euro.

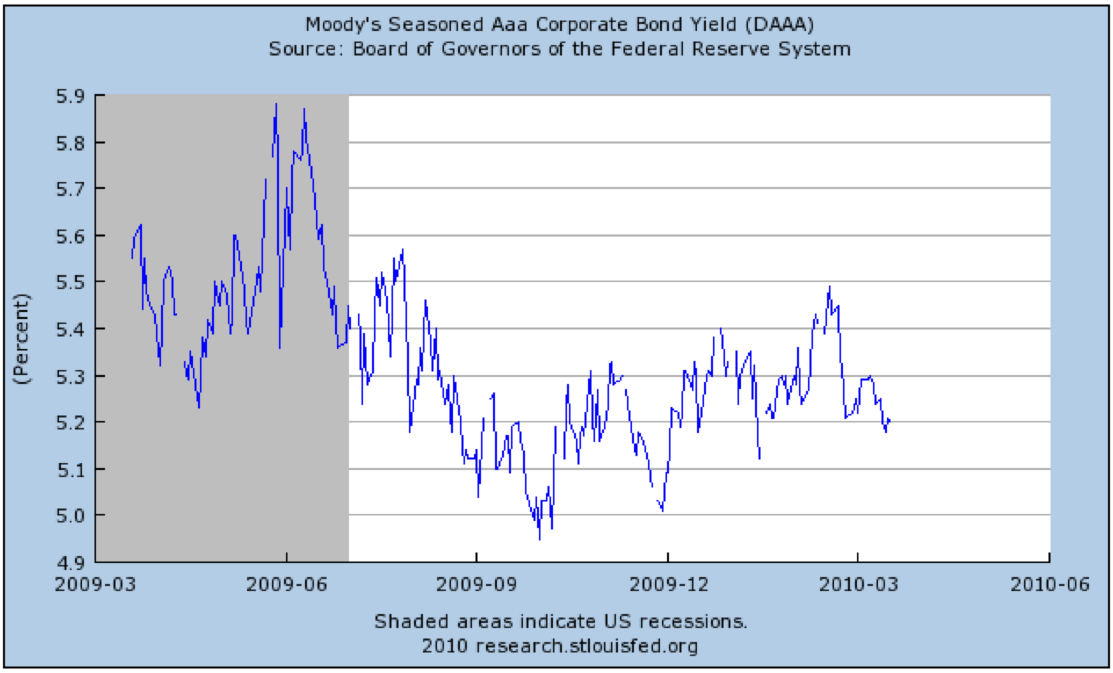
China : Positive
Announcements after the NPC and CCPCC showed that policy changes shall be mild and gradual in China. It was a relief to investors' concerns about policy risk. The central government confirmed that fiscal and monetary policies will remain accommodative. While for the inflation, the central government kept the inflation target at 3% and showed confidence in keeping it under control. Unless CPI jumps, a PBOC rate hike is not expected anytime soon.

Emerging Market : Thailand : Neutral
Streets in Bangkok are again congested by anti-governmental protest. This time the pro-Thaksin camp gathered again to pressure Prime Minister, Abhisit Vejjajiva to call for new election after a court ruling to seize USD 1.3 billion assets from Mr Thaksin. In the last 4 year or so, the pro-Thaksin camp has come back again and again to fight against the government but achieve very little success. And this time, it is unlikely that they will make any difference.

Commodities : Positive
Commodities prices were fairly stable in the last month. Crude oil continued to trade in the range between USD 70-80 while gold hovered at around USD 1,100.

Hedge Fund : Neutral
Strategies that focused on fixed income securities did relatively well in 2010. Up to the end of Feb, Barclay Distressed Securities Index made 2.45% return while Barclay Fixed Income Arbitrage Index rose 2.27%.

Government Bonds : Negative
Data showed that high grade bond yield has risen together with government debts in U.S. and Europe. The 2 charts below are the yield of Moody's Seasoned Corporate Bond Index for Aaa grade corporate bonds and Baa grade corporate bonds. We can see that the blue line failed to breach the low set in late 2009, it means that high grade corporate bond yield has bottomed at that time. Higher yield for corporate bond meant that their prices are under pressure.



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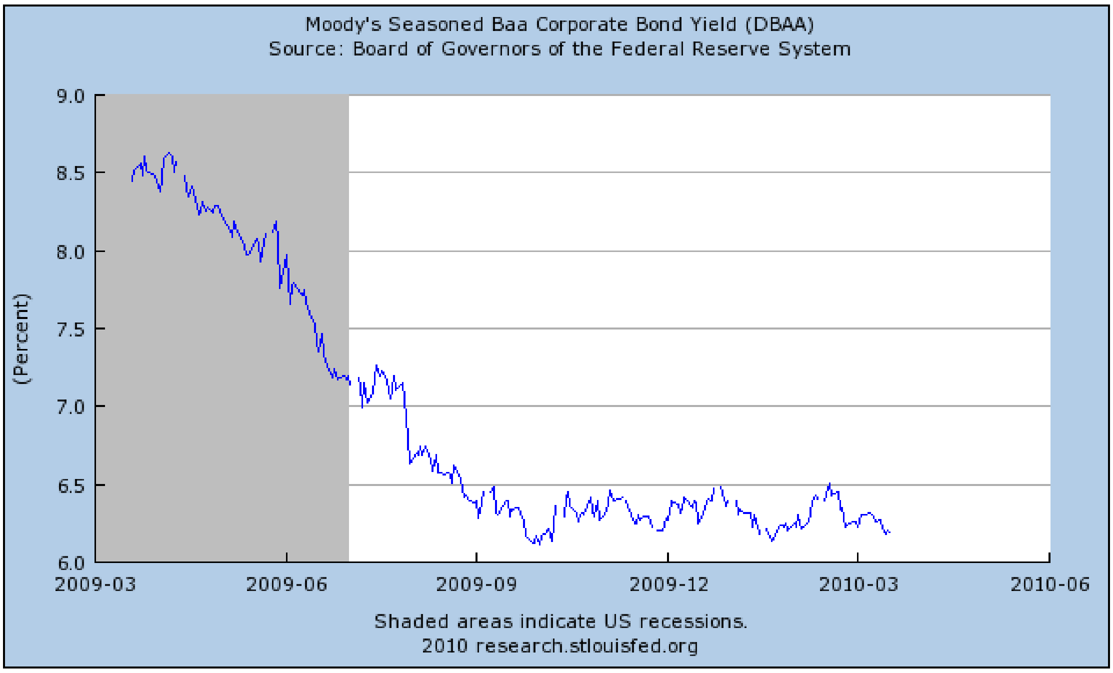

Things to Look Forward :

India pulled the trigger on interest rate hike finally. Actually, many other Asian nations such as China, South Korea, Singapore and Indonesia are also facing rising inflation pressure. It is expected that they will also add to their policy interest rate later in 2010. The fear about interest rate hike is clouding their stock markets now. However, the example of India and Australia showed to us that interest rate hike does not necessary bring about pro-longed adjustments in stock markets. The key is that the prospect for corporate earnings and economic growth must remain bright to support the stock prices.

* All figures and information are collected from Bloomberg.com, Reserve Bank of India, Federal Reserve Bank of St. Louis & Barclay Hedge.

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