AMG Market Commentary

April 2010

RMB exchange rate reform

The debate between China and U.S. on RMB exchange rate heat up again. U.S. Senate threatened to name China a currency manipulator. And the Chinese government response by downplaying the accusation and saying that political pressure would not help on the exchange rate issue.

In fact, the de-pegging of RMB with USD had started 5 years ago. China switched to a managed float system referencing a currency basket in July 2005. In the next 3 years, the Yuan appreciated by some 20% versus the USD. But, the floatation of RMB against the greenback was disrupted by the financial tsunami. Since July 2008, RMB was seemingly fixed at around 6.8 against the USD until now.

The reason behind the “re-pegging” was that volatility in asset prices jumped in the midst of financial tsunami and USD surged sharply against all major currencies. So, China seek to provide stability for the exporters and asset holders by maintaining a stable exchange rate against USD.

But now, we are stepping out of the crisis. For China, the economic growth revived on policy stimulus and strong domestic consumptions. And the policy focus has now shifted to avoid over-heating in asset prices and encouraging domestic consumptions. Appreciation of RMB and more flexible the exchange rate would help in boosting domestic consumption. Moreover, international trade is reviving and the pressure on Chinese exports is diminishing. We would say that the overall environment is getting more and more favourable for the restart of exchange rate reform. So, it is likely that China will get back on track for exchange rate liberalization.

However, we did not expect any abrupt changes. The move shall be gradual and mild. Thereby, the likely outcome would be a return to the managed float system against a currency basket which allows the RMB to craw up against other currencies. The benefit from rising RMB value should be limited to 3-5% a year.

US : Positive

Better economic figures helped to boost stock market. Job data showed that employment situations may be reviving in U.S.. Non-farm payroll figures showed that 162,000 jobs were created in Mar 2010, it was the best figures since Nov 2007. Return of job growth is a big positive for U.S. consumptions and economy. If more jobs are added in the next 2-3 months, it will be a significant signal for sustainable recovery of labour market in U.S. and it shall help to push the market further.

Europe : Positive

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The pledge by EU to provide a safety net for Greece did not help much in boosting investors' confidence in its sovereign debt. Last month, Greek attempted to raise EUR 10 billion in a 12 years debt sales but the actual subscribed amount was only EUR 3.9 billion. It seems that it is only a matter of time before Greek tap into the EU aids package. Fortunately the reaction of the market was only mild. It showed that investors are not expecting a quick fix for Greek. As long as the contagion effect of the sovereign debt problem is limited, the impact on stock markets shall be limited also.

China : Positive
Hong Kong and China stock market picked up as upbeat corporate earnings gave the market a boost. The large state owned banks reported earnings for 2009, and they were largely in line with consensus estimates. It triggered a rally for the financial stocks and helped China and Hong Kong market to play catch up with Asian markets. Companies listed in China shall report their results for 1Q 2010, which could add more fuel to the China and Hong Kong market. Since corporate results were severely affected by the economic downturn in 1Q 2009, earnings growth will be exaggerated by base effect. And in fact, figures from the State-owned Assets Supervision and Administration Commission (SASAC) showed that profits for the central government owned enterprise leaped by more 100% last quarter.

Emerging Market : Thailand : Neutral
What a surprise! Anti government protest in Bangkok finally leads to violent crashes. The Thai army attempted to evacuate the protestors with forces, the crash resulted in more than 20 death and over 800 were injured. Political pressure on Prime Minister, Abhisit Vejjajiva heated up after the violence. The Thai election commission accused the ruling Democratic Party of received illegal donations and call for its dissolution. It seems that it will be some time before political turmoil subsides. We keep the neutral position on Thai market despite the potential for recovery of the losses resulted from the political event.

Japan : Positive
The Yen weakened again on poor domestic recovery. BOJ expanded the quantitative easing operations, it means that interest rate hike is still far from sight. So, the Yen fell back to weakness. The combination of falling exchange rate and pro-long period of zero interest rate makes Japanese Yen an obvious choice for funding carry trade.

Commodities : Positive
Better job figures in U.S. boosted confidence in the sustainability of economic recovery and helped commodities prices. Crude oil rose to around USD 85/barrel. While for gold, it gained on the back of weaker Euro. Still, we do not see high inflation pressure or crisis on any major currencies. We still expect slow appreciation of gold prices.

Hedge Fund : Neutral
Clearer trends in currencies and interest rate was helpful for CTAs. Their performance improved in Mar 2010. Barclay CTA Index showed a 1.16% gain, and the YTD decline shrank to 0.54%.

Government Bonds : Negative
Higher expectations for economic growth and interest rate hike led to pressure on Treasuries. 10 year U.S. Treasuries now yields around 4%. As the economic pick-up continues, the pressure on Treasuries shall remain there.

Things to Look Forward :
Job and retail figures for U.S. improved in recent months, it fuels the upward re-rating for global economic conditions and drive risk appetite. Capital flew to stock markets and commodities again. It helped the stock market to revert from the decline triggered by Greek sovereign debt problem.
Earnings season is starting again and we are going to have the corporate results for 1Q 2020. Corporate earnings shall be helped by base effect. Market focus is again on top line. Improvements in retail sales and reports by Intel pointed to strong corporate demand for IT equipments, it seems that there is chance for upside surprise here too

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

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