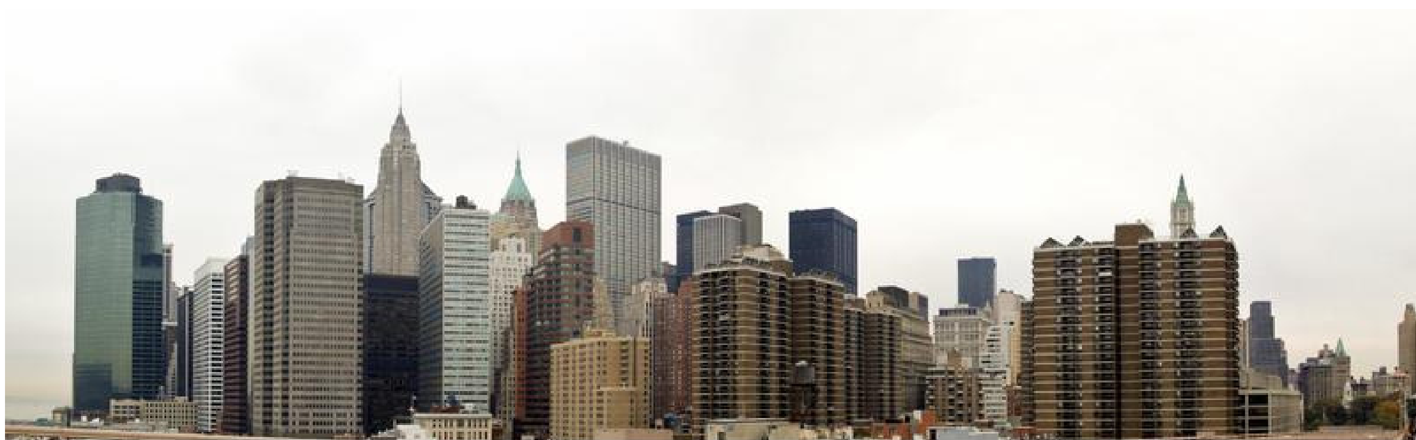

July 2010

Slower growth to weigh on financial market

Weakness in the global economy starts to show again as we get into the later half of the year. Pockets of weakness were showed in recent economic figures. The investment community becomes more aware of the worsening growth prospect. It hurts risk appetite and causes stocks markets, exchange rates and commodities prices to fluctuations.

Judging from the recent changes in U.S. and Europe, a global economy slowdown now seems inevitable. Fiscal tightening by the European governments is going to its tolls and weigh on the European economy. And for U.S., the support from government stimulus is fading while the private sector is just moving slowly. Thus, U.S. will likely be heading for slowdown too.

But, it is not expected to be the end of the recovery. Recent data suggests that the recovery is still going on despite at a slower pace. Examples include U.S. private payrolls continued to show more jobs being created in recent months and the PMI figures for U.S., Eurozone, UK and China are still staying in expansion territory. And nonetheless, emerging markets such as China, Indonesia, India, Korea and the resources exporters like Canada and Australia were still holding up strongly. They shall make meaningful contribute to the global economic growth.

And for the financial markets, we have seen the asset prices being shaken by concerns about the growth prospect last month. It is likely that more selling pressure will come when weaker economic figures are released. But, valuations for stock markets are not demanding and generally below historical averages. Also, corporate earnings are still on the rise. It would lend support to the markets. Thus, we expect more side way movements with lots of volatility in financial markets for coming months.

US : Positive

Recent data shows that nearly every area of the U.S. economy is losing steam. Housing sales, non-farm payrolls, consumer spending and purchasing manager index for both manufacturing and non-manufacturing industries all turned down in June 2010. It is definitely adding to the concerns about sustainability of the economic recovery. But, as we can see from the charts below, key indicators e.g. non-farm payrolls, retail sales and ISM manufacturing and non-manufacturing index still points to expansion despite slipping down from the peaks in previous months. Detailed figures are private payrolls reported a gain of 81,000 in June and ISM manufacturing PMI and ISM non-manufacturing PMI are 56.2 and 53.8 respectively. The 2 purchasing manager indices are still standing above the 50 point mark between growth and contraction. It means that more growth is expected from both manufacturing and service industry in U.S..

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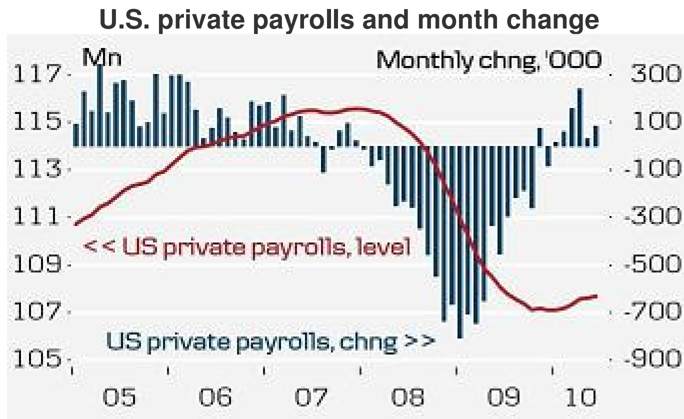
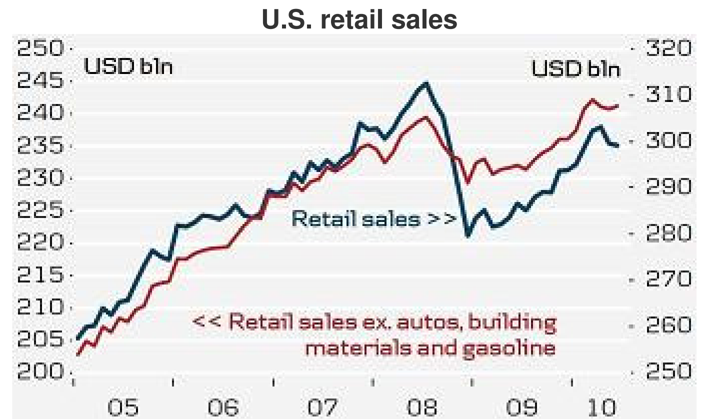
U.S. private payrolls and month change



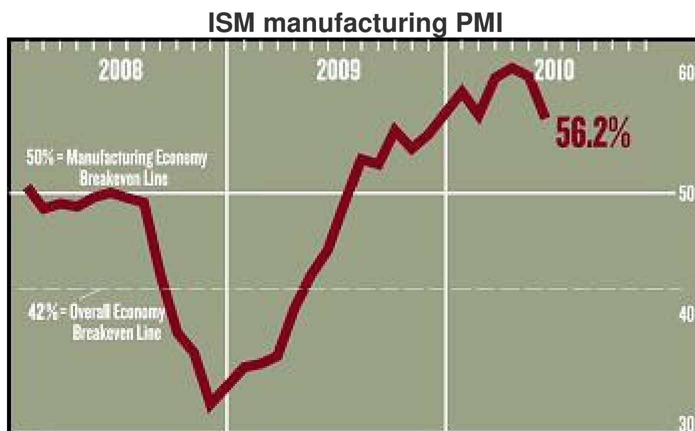
Source: Danske Research

U.S. retail sales



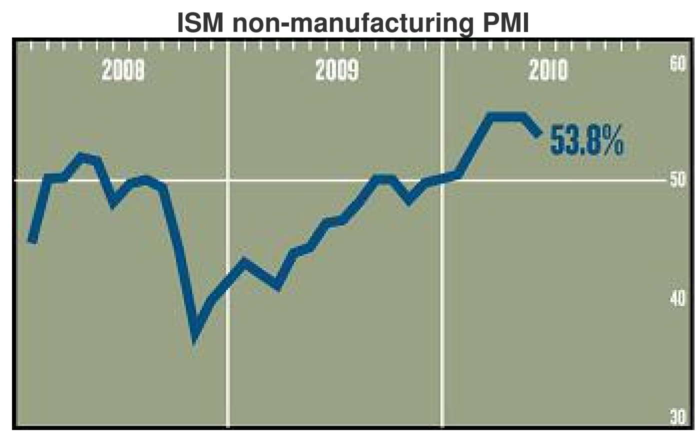
Source: Danske Research

ISM manufacturing PMI



Source: Institute for Supply Management

ISM non-manufacturing PMI



Source: Institute for Supply Management

Europe : Neutral

On 15 July, Greece held its first sovereign debt auction since the EU-IMF bailout. Demand for the 6 months bills was so strong that the Greek government was able to raise more than it originally targetted for. Bids accepted amounted to EUR 1.625 billion, while the target was set initially at EUR 1.25 billion. And the average yield was 4.65%, only 0.1% higher than the auction in April. Being able to raise money again in the market means the liquditiy risk for Greece government is coming down and it now can focus on fixing the public budget and economy. For the finanical markets, we can expect more stablity as the threat of European sovereign debt crisis is coming down also.

China : Positive

Chinese economy is also shifting to lower gear, but we would say it is not an alarming trend. In the second quarter of 2010, China GDP growth fell to 10.3% from 11.9% reported for the first quarter. Besides, industrial production growth is also slowing down significantly. The year on year growth rate reported for June was 13.7%, much lower than around 16-17% reported in previous months. But, it is not a reason for investors to worry about Chinese economy. The overall growth rate is by no means poor and domestic demand is still driving the growth. Latest figures for June showed 18.3% growth in retail sales. It is at par with the growth rate for the first 5 months of 2010 and shows that retail sales growth is still very steady.
Moreover, some moderation is needed for China. Over the past few months, the central government has been

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forging to rein in real estate investments and loans growth lest that asset and credit bubbles will hurt the economy. And the numbers confirms that the effect is starting to show, new bank loans fell to around RMB 600 billion in June 2010 and the property prices slid slightly by 0.1% from the last month according to the National Statistics Bureau.

Japan : Positive
Mr. Kan quickly met a big frustration as the Prime Minister of Japan. His political party, the Democratic Liberal Party was defeated in the Upper House election. And as a result, the ruling coalition lost the absolute advantage in the Upper House. It was perceived as a reaction of Japanese people against the government's proposal to raise sales tax. Obviously, policy initiatives to fix government budget is unpopular in Japan, just like everywhere else. Without the support of the people, Kan and his government could find themselves struggling to push through their policies.

Commodities : Positive
Crude oil price stood steadily over USD 70 a barrel even though concerns about global economic growth prospect arose. But, in stark contrast, gold price fell as demand for safe heaven asset dissipated on stronger Euro.

Hedge Fund : Neutral
Barclay Hedge Fund index lost 0.99% in June 2010. YTD return came down to 0.09%. But, it does not mean there are no good opportunities in the hedge fund area. Barclay Distress Securities Arbitrage Index and Barclay Fixed Income Arbitrage Index beat the general index and gained 5.43% and 5.41% so far this year.

Government Bonds : Negative
U.S. Treasuries and German Bund remain highly sought by investors. Yields for 2 years Treasuries issues was even driven down to historical low at 0.55%. Poorer growth prospect and painstakingly high unemployment in U.S. and much of Euroland means rate hike by the Fed and ECB are coming later rather than sooner. Interest rate risk for U.S. Treasuries and German Bund holders is coming down. So, they become more viable parking vehicle for capital. We take the view that U.S. and European governments are bound to keep interest rate low as long as possible while they withdraw fiscal supports for the economy. And as a result, high grade government bond prices could stay high for some time. But, stocks and commodities are expected to generate better return as the global economic recovery continues. So, we still prefer stocks and commodities related assets for more growth oriented portfolios.

Things to Look Forward :
Latest figures points to slower growth in U.S. while Europe is expect to suffer from tightening fiscal budget in the next 1-2 quarters. It is obvious that the global economic recovery is losing steam and we expect it to weigh on risk appetite and financial markets. Still, we must stress that a slow down to more moderate pace of growth is the likely outcome. And valuation for stock markets is not demanding, it could lend support to the market against significant decline. So, we would expect the financial markets to continue with the side way movements while volatility could be high.

* All figures and information are collected from Bloomberg.com, Danske Research, Institute for Supply Management and Barclay Hedge.

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