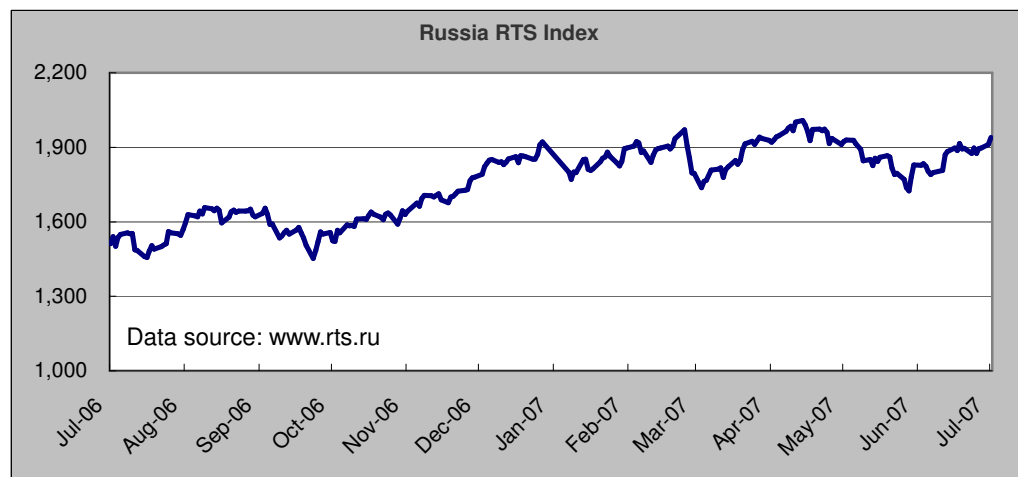




Jul 2007

## Russian equities to wake up?

Eastern Europe equities funds had lagged behind their Asian and Latin American counterparts in the first half of 2007. The sluggish performance was closely related to the weakness in Russian equities market as it had always been the major component of Eastern European funds.



So, did the poor performance indicate a fundamental change in the market, or was it the results of some short term issues?

Looking at the economic data, we did not see any deterioration in the underlying economy. Economic growth and inflation conditions had both improved in 2007. For 1Q2007, the economic growth was 8.8%, higher than the 6.1% figure for 2006. Also, the increase in consumer price for Jan-May 2007 was 4.7%, compare to 5.9% for the same period last year. Moreover, financial status of the country continued to strength despite fluctuation in the price of crude oil. The government petrodollar reserve rose to 8.1% of the countries GDP by the end of Feb even if crude oil prices was just about USD 50/barrel for the first 2 months of the year.

If was it not a down turn of the economy, what were the problems face by Russia market?

There were a few issues, which had clouded the market. First of all, the weakness of crude oil prices adversely impacted the Russia market of which energy companies had a lion's share. Second, we had seen a large trunk of IPOs being pushed through the market during the first half of 2007. It had led to some stress in liquidity and some investors sold their existing holdings to chase for the new counters. Third, elections for Duma and Russian President are coming. It had raised concern about the political stability in the market.

For the three adverse factors, we had seen improvement in two of them. Crude oil prices held up strong and regained strength lately with NYMEX light sweet contracts stayed well above USD 70/barrel. Higher oil prices benefited the energy stocks. Also, the largest new listings e.g. Serbank, VTB, had been completed in the first half of 2007. The drain on liquidity is expected to ease. Moreover, many of the recently listed companies are in domestic consumption e.g. banks, home builders, retailers. So, the breath of the market improved. Investors now have more choices to benefit from rising domestic demand.

The remaining factor is the political uncertainty that comes with the Duma and Presidential

elections. The struggling for power may bring up scandals and cause fluctuations in the market. Still, electoral polls shows that United Russia (political party of President Putin) are by far more popular than any other parties in the country and it shall likely maintain control of the Duma. The results are 57% support for United Russia according to the survey conducted by Yury Levada Analytical Center in June 2007 and 48% support in the survey by Russian Public Opinion Research Centre also in June 2007. If the United Russia keep the strong grip over the Duma, it is likely that the next Russia government will maintain strong leadership.

Overall, we would say the consolidation that is seen in Russian market is a chance for investors to load up with their holdings in Eastern Europe and Russian funds.

Now, let's go through individual markets.

#### **US: Neutral**

US market had dropped slightly in June. DJIA lost 1.61%, S&P 500 lost 1.78% and NSDAQ dropped by 0.05%. The swung of US Treasuries bond yield brought about volatility in equities market. Again, it is caused by speculations on interest rate expectation while the Fed kept on hold once more. In fact, US market has got no focus and just move sideways recently.

#### **EU: Neutral**

European markets took a rest after the strong run. DAX gained 1.58% while CAC and FTSE lost 0.8% and 0.2% respectively. It seems that the market is losing momentum and entering a consolidation. Although economic data remained upbeat, it is unlikely that it will start another rally in near future.

#### **Japan: Neutral**

Japanese stocks edged up slightly. NIKKEI made 1.47%. Economic data looked better recently. Machinery orders and retail sales both rose in March. These are good signs for Japanese economy, but it would take a more consistent trend to make them convincing evidence for Japanese economic recovery.

#### **China: Slightly positive**

HSCEI shoot up again and the financial companies were the leaders. The index jumped 11.75% in the month. The Chinese A share markets remained very buoyant in the first half of 2007 and it benefited the financial stocks e.g. banks got more fees income and insurers got better investment return.

#### **Hong Kong: Positive**

HSI headed up also. It had gone up by 5.52%. Again, the Chinese enterprises as well as the China plays were the best performers. Turnover in Hong Kong stock market has breached HKD 100 billion mark recently and it indicated very strong liquidity inflow to the equities market.

#### **Emerging Markets: Positive**

Other than HSCEI, Taiwan and Thailand had also done very well in June. Taiwan gained 9.06% and Thailand made 5.34%. It seemed that there were some money flowing to the less expensive markets within the region. For Eastern Europe region, Russia and Hungary shown 6.50% and 8.33% gain respectively. As discussed before, there are several positive changes in Russia and we think that Eastern Europe is the choice for now.

#### **Bonds: Slightly negative**

10 years US Treasuries yield held well over 5% level, it became a pressure on bond prices. Speculation about Fed action continued despite that the Fed remained on hold. The situation is expected to continue and bond prices to remain under pressure. Global tightening continued with EU added another 25bps to its interest rate and Bank of Japan's stance toward rate increase strengthened. These all had an adverse impact on bond prices.

**Commodities: Slightly positive**

Crude oil ran up in June and broke the USD 70/barrel level. High season for oil demand in Northern Hemisphere had just started and disruption of oil production in Nigeria became the catalyst for Crude oil to climb again. Seasonal effect could help oil price to stay high. Gold prices continued to consolidate and slid to USD 648/ounce by month end, down 1.82% in the month.

**Hedge funds: Neutral**

Performance for hedge funds in May was again very good. Three of the HFRX sub indices gained more than 3% in just one month. They are HFRI Marco Index, HFRI Event Driven Index and HFRI Equities Hedge Index. Their returns were 3.78%, 3.15% and 3.02% respectively.

**Advices for investors**

Economic trends shown no significant changes. Also, central banks action had been very much predictable. Still, developed equities market slowed down a bit after the strong rally in the last 3 months.

Currently, our favourite market is Eastern Europe for the recent changes in Russia. After the completion of several big IPOs, the liquidity conditions in Russia market shall improve. Moreover, the new listed companies enhanced the opportunities to ride on growing domestic demand in the country. Although concerns about coming elections may result in fluctuations in the market, it is probable that the political conditions would not change much after the elections. United Russia will likely maintain control in the government and ensure strong leadership.

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