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Market calmed down, but confidence is still weak.

To control sub prime problem and protect the banking system from liquidity crunch, central banks of US and European countries made massive injection of liquidity to the interbank market. On Aug 17, the Fed cut US discount rate by 0.5% to 5.75%. The market interpreted that as a step towards policy rate cut in the coming future. Equities markets reverted the sharp downward trend and recovered part of the losses since late July. So, was it the end of the turmoil?

It seems that the equities market calmed a bit after the central banks action. But, a lot of uncertainties are still there.

Liquidity condition in interbank market remains tight. US interbank rate and EURIBOR show no signs of recede despite massive injection of cash by the Fed and ECB. Not knowing the impact of sub prime mortgage problem on the financial status of each other, banks still lack the confidence to lend to each other. As interbank rate is an important reference for cost of capital for banks, high interbank rate may pass along to lending market and negatively affect general economy if it stays high for long.

Also, the US economy shows more signs of slowdown outside housing market. Recent job market data indicated weakness in employment market. Non farm payroll had the first drop in August 2007 since August 2003. Since income from work has been a major force to support US household consumption against slowing housing market, weakness in job market could further pressure on US economy.

Still, it is too early to conclude that US will go into a recession. Consumer spending has hold up well until now, it is a strong support for the general economy. Moreover, the Fed is expected to cut interest rate to prevent abrupt slowdown in US. It would be a boost to investors' confidence.

We would say Asian regional funds would be a buy for now. That is because Asia countries have low exposure to sub prime mortgage related securities and direct losses is low. However, investors should be cautious about a significant decline in US consumption and import is a risk to this investment.

US: Slightly negative

Despite a poor start, US market ended August with a gain. DJIA rose 1.10%, S&P 500 made 1.29% and NASDAQ up 1.97%. Further signs for slowdown in US economy were seen. Job market showed weakness and housing market continued with the downward trend. So, the prospect for US economy seems a bit dimmer. On the other, the market is now expecting Fed rate cut within the month. The rate cut shall be an immediate boost to investors confidence.

EU: Neutral

European stocks markets were weak. DAX gained 0.71%, CAC lost 1.80% and FTSE down 0.71%. Massive capital injection to the interbank market by ECB eased the worries of investors. However, banks were still very cautious about lending in the interbank market. So, EURIBOR continued to rise and liquidity glut was still severe in European countries.

Japan: Negative

Japanese stock market continued with the weak performance. NIKKEI declined by 4.90%. Japanese Yen retreated from 111 to the dollar in the middle of the month to around 116. As a strong Yen is unfavourable to carry trade investors, a weaker Yen help boosting

confidence. Moreover, Japanese Prime Minister Abe resigned recently. It demonstrated the lack of strong leadership in the country, which may translate into difficulties to carry on with the economic reform.

China: Slightly positive

HSCEI had made a record high and jumped 7.29% in August. Following the expansion of QDII quota, the Chinese government approved direct investment in Hong Kong stock market by retail investors. It turned the market sentiment around and boosted stock performance.

Hong Kong: Slightly positive

HSI also made a new high. The index gained 3.45%. Same as China, expectation for capital inflow from the mainland was a strong force to support the market.

Emerging Markets: Slightly positive

Emerging markets recovered also as US market rebound. Asian markets recovered well. KOSPI recovered nearly 60% of the drop, Singapore Strait Times also got back more than 50% of the loss. It reflected stronger market confidence and better liquidity conditions in the region. Given that the Asian financial institutions are not investing heavily in US sub prime securities, direct impact of losses from sub prime mortgages is not high. However, decline in US consumption and import is still a risk to Asian economies.

Bonds: Slightly negative

US Treasuries yield was compressed by market expectation for Fed rate cut. 10 year Treasuries yield dropped to around 4.50%, the lowest since April. It indicated the risk appetite for investors remained low and flight to quality continued. For corporate bonds and emerging market bonds, the high risk aversion is still very unfavourable for them.

Commodities: Slightly positive

Crude oil and gold remained stable in the month. Crude oil moved to USD 74/barrel on hurricane threat to Mexico Gulf. Still, it is just a short term driver for the prices. Going into fourth quarter, heating demand and drawdown on inventory would be more important factor. Gold stayed at around USD 670/ounce.

Hedge funds: Neutral

Hedge funds performance was harmed by abrupt decline and cash outflow as redemption demand was high. HFRX marco index dropped 7.38% in August, HFRX relative value arbitrage index declined by 2.62% and HFRX equity market neutral index also lost 2.17%. Still, as stock market stabilize, hedge funds performance would likely improve.

Advices for investors

Confidence problem and psychology impact of the sub prime problem was eased by central banks action. Equities stabilized after that. However, uncertainty about liquidity condition as well as the long term impact of poor housing market on US consumers still exists. However, the Fed shall respond by cutting interest rate if the risk of abrupt slowdown became prominent. It can help to ease the worries about economic future and boost investors' confidence.

At current stage, Asian region fund would be a viable investment. Still, investors need to keep an eye on development of US economy, especially imports. It is because declining US imports is a threat to Asia too.

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*Arcadia Financial Services (Asia) Ltd
Arcadia Asset Management (Asia) Ltd
1402-1403, Tower 1, Times Square, Causeway Bay, Hong Kong
Tel: (852) 2114 8488 Fax: (852) 2111 0777*