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Gold rides on weaker currencies

September was marked by recovery of risk appetite in the market. 10 year US Treasuries prices went down while risky assets e.g. equities markets and commodities prices went up. It showed that investors were pulling their money out of safe heaven and put them back into market for return.

So, the worries about tight credit conditions faded and investors flocked back to take risk. Did it mean that we had gone back to the status before the financial turmoil? Not, in fact. Central bank policy focus had changed from stemming inflation to avoiding abrupt slowdown in economy. Now, they are more inclined to ease on interest rate than to tighten. With such a change in policy focus, the Fed cut US interest rate by 50bps in September. ECB and Bank of England also softened on their hawkish stance and refrained from adding further to the interest rate.

Lower interest rate expectation made USD less attractive for investors, so they started to seek for alternatives. Gold, Euro, Sterling and high yield currencies were alternative for investors and they could benefit from weaker USD. But, the chance for more interest rate hike had turned down for Europe and UK. In other words, the attractiveness of Euro and Sterling were also declining. It all made gold a very obvious choice. Gold prices advanced after consolidating for more than a year, it finally breached the previous peak in 2006 at USD 730/ounce in September. It seemed that gold price had regained momentum on declining USD.

Going forward, as slower housing market is expected to continue to drag on US economy. The Fed shall likely adjust the interest rate downward, it would lead to further weakness in USD. More money will flow into gold and drive up gold prices. So, we think that it is the time for accumulation of gold related assets.

US: Slightly negative

US equities market recovered. DJIA gained 4.03%, S&P500 made 3.58% and NASDAQ was up by 4.05%. US stock market gained on fund outflow from US Treasuries issues. This kind of fund flow shall provide support for the market in near future. On economic front, slower housing market would continue to drag on overall economy. But, more data is needed to assess the impact on other areas. If incoming data shows that the knock on effect is serious, the Fed shall US interest rate further. It would lead USD lower.

EU: Neutral

European markets also went up a bit, but they were still behind US market. DAX moved up by 2.29%, CAC made 1.19% and FTSE100 recovered by 2.59%. The recovery was also driven by risk appetite coming back. However, Europe is also facing risk of slower economic growth. German retail sales figures declined for two consecutive months in Aug and Sep and ZEW business confidence index also dropped a lot. So, Europe, US and Japan are all clouded by risk of slower growth, it demonstrates the strength of emerging market growth.

Japan: Negative

Japanese stock market came back a little, NIKKEI made 1.31% gain. Japanese Yen depreciated quickly against the major currencies from the middle of September. The sharp decline of Japanese Yen is another signal for the return of risk appetite. For equities market, we remain negative as economic data is still mixed while weaker Yen reduces the return for overseas investors.

China: Neutral

HSCEI jumped by 18.68% in September. The major catalyst for the recent rally was the expected capital inflow from China. The index jumped by nearly 70% since it bottomed out on 17 August. As said in September issue, the market seemed to have over-run in the short term. Thereby, we would not suggest investors to chase in, rather off-loading at current level is appropriate.

Hong Kong: Neutral

HSI also jumped 13.32% last month. The market was very much driven by Chinese stocks and expected cashflow from China. So, we take the same stance as to China and suggest investors to offload.

Emerging Markets: Slightly positive

Emerging markets out-performed developed market again. The recovery of risk appetite had been very favourable for emerging markets. During the month India jumped 12.86%, Brazil ran up 10.67%, Singapore rose 9.23% and Russia was also up by 7.91%. Despite higher volatility, emerging markets remained supported by strong growth and re-emergence of risk appetite.

Bonds: Slightly negative

Medium to long term US Treasuries gained on flight to quality previously. However, 10 years US Treasuries yield went back up in September. It showed that investors left the shelter port to chase for better return. Cash outflow shall drag on medium to long term Treasuries performance. On the other hand, short term Treasuries bills benefited from expected rate cut. Still, the current level of yield at around 4% is unattractive.

Commodities: Positive

Crude oil and gold had very strong performance in recent days. They had weathered the downturn well and gained strength on weaker dollar. In September, gold rose 10.45% and crude oil made 10.08% gain. Commodities are still our favourite as lower rates and weak USD shall benefit them.

Hedge funds: Neutral

Hedge funds recovered as market regained strength. HFRX Marco Index made 4.79% in September, HFRX Convertible Arbitrage Index gained 2.56% and HFRX Event Driven Index reported 1.08% return. On the down side, HFRX Equity Market Neutral Index lost 1.73% and HFRX Distressed Securities Index dropped 0.33%. Going forward, hedge fund performance is expected to improve as stock market recovers.

Advices for investors

Investors' risk appetite recovered and money flowed out from US Treasuries to risk the market again. As a result, the stock market rebounded very strongly. Fund flow could provide support to stock market in near term. Moreover, growth prospect of developed markets is getting dimmer, it could drive more fund flow to emerging markets and push their performance higher.

For investment choices, we would say gold is expected to benefit from lower interest rate expectations. With lower interest rate, the appeal of gold against the major currencies would rise and drive up gold price.

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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*