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The tide has turned, be defensive towards equities.

2008 started with a low note in equities markets. Double digit loss was common among equities market in Jan 2008. Stock indices for Germany, France, Japan, Hong Kong, Korea, Russia, India and many other countries all had fallen by more than 10%. The massive draw down was driven by swelling sub prime related write off and scandal about fraudulent trade of Societe Generale.

So, it was what happened and it is now time to give the market a review.

Looking at the fundamentals, the market is still facing a lot of challenges. First, sub prime write off problem is expected to continue. In 4Q2007, sub prime related write off continued to swell for banking sector. Also, the underlying housing market was still declining. In Nov 2007, the average house prices dropped by 7.7% yoy, it was the largest drop reported. So, no real improvement was seen and it shall continue to pressure on equities markets. Second, US debt insurers are at risk of credit downgrades. If that happens, the value of the bonds backed by them shall decline. It could trigger another round of write off in banks assets. Last but not least, the economic slowdown was spreading out. In US, latest economic data shown job market and services industries were getting weaker. In EU, Germany and France both reported slower growth in 4Q2007. Weaker growth is another threat to earnings and stock prices.

Technically, many markets also shown signs for turning into a downward trend. These include medium term moving average falling through long term moving average, indices made lower highs and low lowers. So, technical indicators also points to difficult market conditions.

Both fundamental and technical factors shows that the tide seems to have turned for equities markets. So, investors should reduce their exposure to equities market and divert their assets to other areas. Here agricultural commodities investment is a very viable choice. In the last few months, we could see that the agriculture products futures continued to rally despite poor equities markets performance. It just demonstrated how they could help to diversify away equities market risk. And there are some mutual funds, which make direct investment in commodities futures rather than equities. They shall be good investment choices given equities markets are not expected to do well.

US: Negative

US stock market dropped again. DJIA declined by 4.63%, S&P 500 dropped by 6.12% and NASDAQ fell 9.90%. The US market is facing a slowing economy and risk of further assets write off by banks. The latest ISM non-manufacturing index dropped to 41.9, which indicated contraction in US services industry. It echoed with the rise in unemployment rate in Dec 2007 to show that US economic slowdown was spreading out from equities market. Moreover, the problem with credit market was still there. Besides falling house prices and swelling write offs. The focus had shifted to debt insurers recently. US debt insurers e.g. AMBAC, MBIA are now at risk of credit downgrades. If that happens, the value of the bonds that they are backing shall fall and it could trigger more write off in the banking sector. Overall, there are still many challenges lying ahead and the market is now very vulnerable to bad news.

EU: Negative

Europe markets were falling sharply on the scandal of Societe Generale, DAX slumped by 15.07%, CAC fell by 13.26% and FTSE100 lost 8.94%. European markets were in similar position to US. UBS reported the biggest quarterly loss in banking history mainly due to sub prime write off. It shown that the sub prime problem is no less severe in Europe.

Moreover, 4Q GDP growth slowed significantly in Germany and France. It echoed with weak business sentiment and pointed to further economic slowdown.

Japan: Negative

NIKKEI lost 11.21% in Jan 2008. Japanese equities market remained tight in the down market. Every bounce up was weak and ended up with a more severe decline. Until now, Japanese market showed no signs for it to get stabilized.

China: Neutral

HSCEI declined by 22.57% in Jan 2008. The sell off was much more severe than what I initially expected. Still, fundamental factors of China is still better than other markets with strong economic growth, good corporate profits and healthy liquidity conditions. Still, looking at the technical side, it is not so affirmative. HSCEI had been struggling around 250 days moving average for some time. I would follow the market movement and keep check about whether it is turning into bear market. Still, it is not the case until now and I suggest investors to hold on to their China investments.

Hong Kong: Neutral

HSI lost 15.67% in Jan 2008 and it dipped to 21,700. Again, Hong Kong is just so similar to China. HSI is also struggling around 250 days moving average and I suggest to hold on and observe whether the market will start another rally or turn into down trend.

Emerging Markets: Slightly negative

Last month when I summarized emerging market performance in 2007, I have noticed that many emerging markets had started to follow developed market and stalled in the later part of 2007. Brazil, Russia, India and Malaysia were among the few that continued to do well. But in Jan 2008, they did not escape the general fall off. Malaysia lost 3.58%, Brazil dropped 6.88%, India lost 12.61% and Russia also fell lower by 16.74%. Although these countries has yet to confirm they are in bear market, they shall likely be affected by the movements of developed markets, especially if they fall sharply. So, I think it is also time to offload emerging markets holdings.

Bonds: Slightly positive

Given a downward moving equities market, investors may have more interest in the bond market. Here we could look at 3 factors to check out for investment opportunities, they are interest rate trends, exchange rate trends and yield spread. For the interest rate trends, it is favourable as most major countries are expected to lower interest rate with economic growth at risk. Still, exchange rate trends and yield spread are not so positive. For exchange rate issue, US dollar rebound recently as interest rate differential with EU and England may tighten as the European countries are expected to lower their rates. Moreover, yield spread stayed high as credit market remained tight. Overall, high grade bonds is my choices to defend against falling equities market as it is expected to benefit from falling interest rate and less affected by yield spread problem.

Commodities: Positive

Commodities really stood out in the falling equities market. Gold rose by 10.90% and agricultural products continued to do well despite poor performance in equities market. Another good point about commodities investment is that it offers investment opportunities outside of equities markets. There are investment funds investing in futures markets and physical commodities. By placing money out of equities markets, investors could achieve better diversifications.

Hedge funds: Neutral

Jan 2008 is another down month for hedge funds. The HFRX Global Hedge Fund Index declined by 2.06%. The relative out-performers were HFRX convertible arbitrage index, HFRX merger arbitrage index and HFRX distressed securities index. Their were 0.43%, 0.65% and 1.40% lower respectively.

Advices for investors

The equities market is expected to face a lot challenges ahead, and technically speaking many of them have turned around. So, I would suggest investors to reduce their exposure to equities market and seek for alternatives.

Commodities investment allows investors to put their money outside equities market and they are doing very well. Thereby, I would suggest investor to add commodities investments to their portfolio and shift asset away from equities markets.

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