



Mar 2008

Agricultural products prices on the rise

Equities market calmed a bit and many of them had a rebound in Feb. Still, the rebound was brief and weak. However, much of the gains were given back in early Mar.

While stock market performance was poor, return were still coming from other investment vehicles. Agricultural products were among the winners in the recent months. In fact, the prices for many soft commodities skyrocketed in 2007. According to United Nations, its FAO food price index jumped 37% last year.

Though that the performance was eye catching, sharp rises in the agricultural products prices were often the result of short-term supply shock. So, what is driving the prices up this time?

We think strong demand played a major role in the price rise, while other factors e.g. falling USD and investment money flow were adding fuel to it.

Let's look at the supply and demand conditions first. Below is the chart for world stockpiles for 2 major soft commodities, namely wheat and corn.

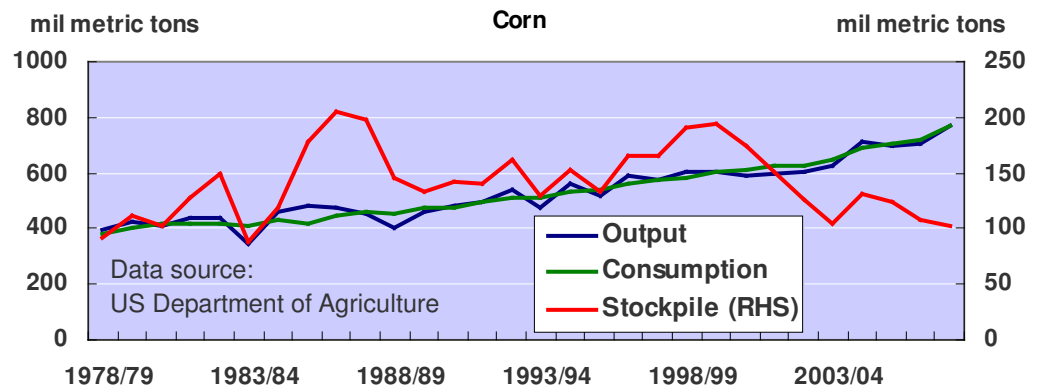


Chart 1: World corn output, consumption and stockpile

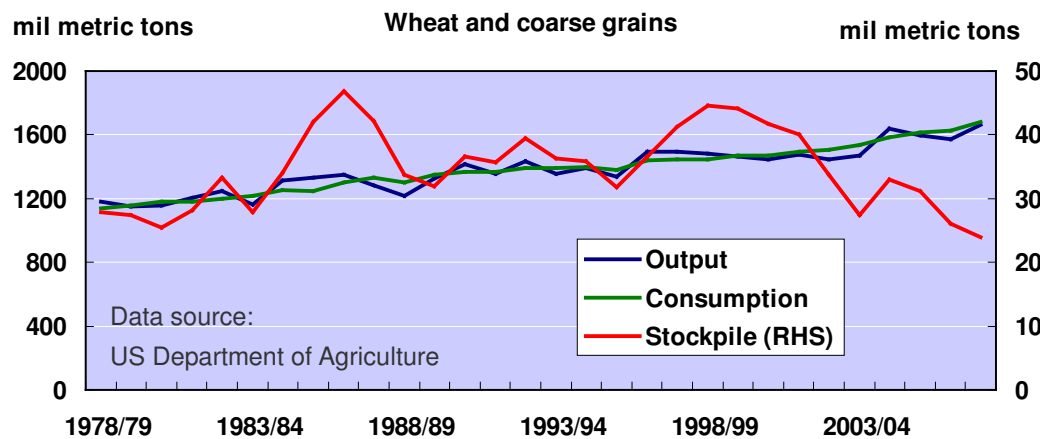


Chart 2: World wheat and coarse grains output, consumption and stockpile

From the charts above, I want to make 3 points.

1. Supply conditions is very tight, we can see sharp draw down on stockpile of both wheat

and corns. Comparing to the previous peak in the late 1990s, the stock level dropped by nearly 50%.

2. The drawdown occurred in the period of rising supply. It showed that demand had been rising even faster.

3. The stockpile for 06/07 harvest year continued to drop, there is no signs for the trend to stop.

Putting them together, it depicted a supportive environment for agricultural prices. Firstly, the prices rise was driven by strong demand growth rather than sudden disruption to supply. Secondly, we do not have a large buffer (stockpile) to protect us against decline in supply. Thirdly, the drawdown in stockpile is getting more serious. It explained why investors were looking at the agricultural futures again.

While the environment was turning more favourable for agricultural products prices, stock market started to fall late 2007. So, investors need for alternative investment was woken up again. It seemed that agricultural products was one of the safe haven and attracted some investment cashflows.

Overall, the supply and demand conditions remained supportive for agricultural products. So, we remain positive on agricultural prices. Still, agricultural products are very volatile themselves and recent investment cashflow could make the fluctuations more vigorous. Investors shall avoid over exposure to this sector.

US: Negative

US stock market had the fourth consecutive declining month. DJIA down by 3.04%, S&P lost 3.48% and NASDAQ dropped 4.95%. On economic front, an US economic recession became a realistic expectation. Job market data suggested a dimmer prospect for US economy, in Feb, non-farm payroll had its second consecutive month of decline. Overall, US is expected to head down in equities market as well as economy.

EU: Negative

Europe markets had been quiet in Feb, although they recovered slightly from the aftermath of massive slumps in Jan. The rebound was very weak. DAX dropped by 1.51%, CAC was down by 1.96% and FTSE100 went up 0.08%. European markets were just following the US recently, so the market is still weak. Although Euro is rising on expanding yield advantage over USD, it is not enough to compensate the risk of stock markets. So, we remain negative on EU.

Japan: Negative

NIKKEI edged up by 0.08% in Feb 2008. Although Japanese market had already fell some %, it remained very weak and we would like to reiterate that any rise are probably rebound.

China: Slightly negative

HSCEI recovered by 11.59% in Feb 2008, however, most of the gains were given back in early Mar. We have been waiting for a rebound in the last few months. So, it did come in February. But, it was just short of my expectations and it did not last. Now, the market came under pressure of falling A share market again.

Hong Kong: Slightly negative

HSI gained 3.73% in Feb 2008. Good news did come for Hong Kong market, e.g. satisfactory earnings reports for blue chips companies, government making tax cut on strong budget surplus. However, it did not help to turn the market back to strength.

Emerging Markets: Negative

Similar to HSCEI, several of the emerging markets had a good rebound in Feb. However, they also gave back most of that rebound in early Mar. After the drop in recent days, the only major emerging market which still stood near previous peak was Brazil. For the others markets, rebound were weak. It showed that liquidity conditions were no longer favourable for emerging markets. We continue to suggest investors to reduce exposure here.

Bonds: Slightly positive

General condition for bond market has not changed much. Interest rate trend is still favourable. Poor economic data suggested e.g. lower non-farm payrolls in US and declines in non-manufacturing ISM in EU all suggested economic slowdown ahead. It shown that the major central banks were still under pressure to cut rates or at least avoid raising their interest rates.

Commodities: Positive

Crude oil became the leader in Feb, it rose 11.% and gold also made 5%. Agricultural commodities also continued with their rally. Overall, precious metals and agricultural futures remained unaffected by equities market slump and continued to deliver strong performance.

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

Equities market and economic conditions are heading down. But even if equities markets are in down trend, there would be some rebound occasionally. Investors better take the chance to reduce their equities exposure.

Gold, commodities and alternative investment are what we favour for now.

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*Arcadia Financial Services (Asia) Ltd
Arcadia Asset Management (Asia) Ltd
Room 1404 &06, Leighton Centre, 77 Leighton Road, Causeway Bay, Hong Kong
Tel: (852) 2114 8488 Fax: (852) 2111 0777*