



Apr 2008

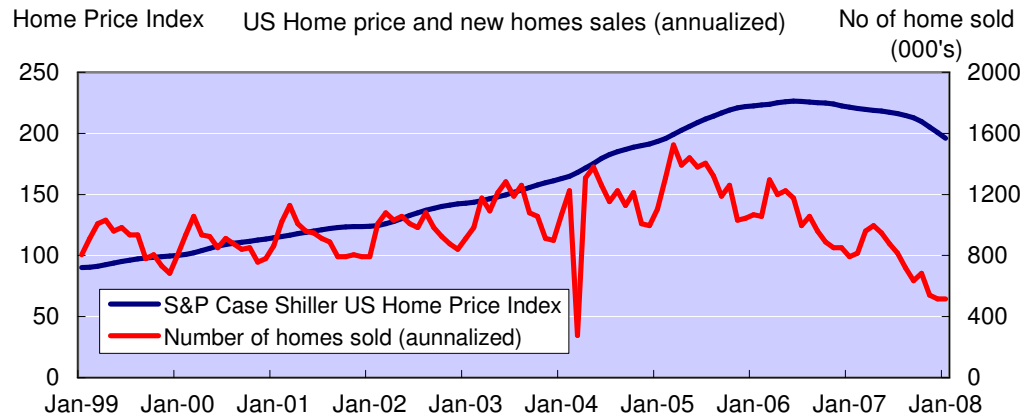
Confidence came back, but growth did not!

Equities markets rebound again in the last days of Mar 2008. Fed quick action to avoid bankruptcy of Bear Stearn brought back investors confidence and the market came back from the washout triggered by Bear Stearn problem.

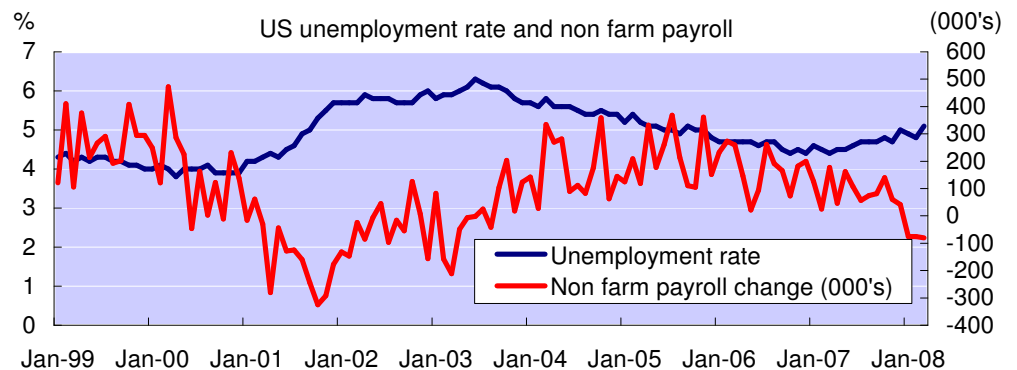
When Bear Stearn reported to the Fed that it was going to file for bankruptcy, the Fed reacted promptly and arranged a takeover by JP Morgan. What had surprised the market was that the Fed had given guarantee for USD 30 billion of Bear Stearn's assets. It showed to the market that the Fed was willing to take unconventional steps to ensure the well being of the financial system. Investors reacted by getting back into the market and drove up stock prices.

So, does it mean the stock market is safe to play now?

For this, we shall need to have a check on the general economic conditions. Here we shall go over 3 areas, the housing market, the job market and leading business indicators.

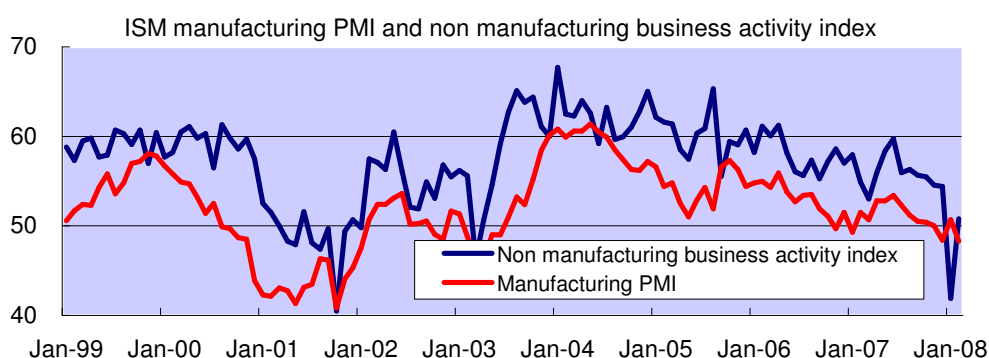


First of all, the housing market showed no signs of turnaround or stabilizing. Looking at the charts above, we can see that the number of homes sold and house prices are both falling. The latest figures are S&P Case Shiller Home Price Index (yoy change 1 %) and Number of homes sold (yoy change - %) So, US housing problem is still getting worse and the pressure on home owners is still rising.



The job market is also weakening. Non farm payroll change has turned negative for 3 consecutive months to Mar 2008. So, the US is losing jobs. Looking at the unemployment

rate, it also confirms that labour market condition is turning down. The unemployment rate rose from 4.4% in Mar 2007 to 5.1% in Mar 2008. So, more and more American had lost their jobs. In addition to negative wealth effect due to falling home prices, it shall pressure on US household income and consumption.



Lastly, the data for business activities is showing weakness also. The ISM manufacturing PMI and non manufacturing business activity index both slid quickly in the last 3 quarters. Latest data showed that both manufacturing and service industry in US are at the edge of contraction.

To sum up, US housing market is still in contraction phase and we can see that it is feeding through to other areas of the economy as indicated by slowdown in business activity as well as the lost of jobs. We should say that the US economic slowdown is no longer contained in housing market. Given a slowdown in general economy, it could affect the profit of companies outside of housing and financial sectors. Thereby, we disagree with the view for a bottom out of the US market and remain negative about equities.

US: Negative

DJIA ended the month of Mar with % gain, S&P 500 rose and NASDAQ moved up by %. Fed prompt action to avoid bankruptcy of Bear Stearn brought back investor confidence and equities market rebound in late Mar. However, economic data suggested that the economic slowdown has spread to job market and business conditions. It is a threat to consumption and thus corporate profits. Thereby, the downside risk of the market is still high.

EU: Negative

European market dropped also. DAX was down 3.16%, CAC lost 1.41% and FTSE100 went down by 3.25%. European market rebound together with US. Similar to US, European economy is also heading to slowdown. In the latest Eurozone Economic Outlook published jointly by Ifo Institute of Germany, INSEE of France and ISAE from Italy, they suggested that Eurozone industrial output would be dragged down by global economic moderation. Consumption in the region was also expected to be eroded by high crude oil prices. So the environment is not favourable for corporate profits and stock market either.

Japan: Negative

NIKKEI lost 0.33%. The Japanese Yen has strengthened a lot against USD. It finally broke the 100 Yen to USD level in Mar 2008. It represented a 24% appreciation over the last 10 months. The strength of Yen shall erode the country competitiveness in exports and hinder economic performance.

China: Neutral

HSCEI dropped another 13.27% in Mar. Stock price of Chinese enterprise has shown violent swings in recent months. After the adjustments in the last few months, the prices of some Chinese enterprise went back to more reasonable levels. Now that the problem clouded the market are seemingly endless decline in A share markets and worries about industrial exports. We would put China market back to observation.

Hong Kong: Neutral

HSI lost 6.09% in Mar. The factors affecting Hong Kong companies are just the same as the Chinese companies and we also put Hong Kong market back to observation.

Emerging Markets: Slightly negative

Emerging markets movement resembled that of the developed markets. The market has been worried about the impact on emerging markets due to economic problems in US. Now that it had spread out from housing market and the impact on emerging markets is expected get more obvious. So, it is still expected to follow the developed market movements.

Bonds: Slightly positive

Under the threat of further slowdown, the Fed is expected to cut rate further. The current Fed fund rate is 2.25%. It is just obvious that the room for further reduction is limited. So, the impact of Fed rate cut shall recede in coming months. Still, there is some favourable development in bond market. The Fed had extended the acceptable collateral for loans to commercial banks to include corporate debt and mortgage securities with high credit ratings. It helped to reduce the liquidity risk to hold them. Recently, we have seen some private equity funds purchased some leverage loans valued at USD 120 billion from Citigroup.

Commodities: Positive

Commodities had an adjustment as the dollar and equities market rebound. However, the strength of the equities market and USD was interrupted by poor corporate profits of GE. As the equities market retreat, gold and agricultural products stabilized quickly. Overall, we believe the adjustment is just the result of short term fund flow rather than a long term strengthening of USD. Thereby, we suggest that it is a chance for investors to accumulate he/her position.

Hedge funds: Neutral

The headline HFRX Global Hedge Fund Index declined by 2.46%. However, HFRX Equity Market Neutral Index and HFRX Merger Arbitrage index gained 2.05% and 0.23% respectively.

Advices for investors

Equities market rebound towards the end of Mar as the Fed's action prevent the fall of Bear Stearn. While the panic sales had stopped, we can see that the underlying economy is in fact getting weaker, which is yet to be reflected in the market. Thus, we remain cautious about equities market.

On the other hand, gold and commodities had retreated as investors went back to equities market. Still, they stabilized very quickly as equities market's rally was just short. We think the adjustment is a good chance to get your position in gold and agricultural products.

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