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## Vietnam falls, but Asian markets shall stand the test

Vietnamese stock market have fallen more than 50% since the year begin. For its currency, the Dong, it is also under strong pressure to depreciate. Currency forward shows that it is expected to lose 25% more at the end of the year. Equities market slumps and currency value falls, it just looks like what happened 10 years ago in Asia. At that time, the financial crisis stroke Thai and then swept through the whole region.

What's happening in Vietnam has triggered worries about another Asian financial crisis. But, we believe the risk for another wide spread financial crisis in the region is not high because financial positions of government and corporations are much better now.

At the time of the Asian financial crisis, the Asian countries had many problems in their currencies and financial positions. Most of the Asian countries were pegging their currencies to USD or using a managed float currency reign. But some of them just have very little foreign reserve to defend their currencies against speculations. In other words, they were easy prey for speculators. Moreover, the Asian enterprises and government were heavily in debt and lots of their liabilities were short term and denominated in USD. When their currencies fell against USD, the loans amount escalated in local currency terms. Many corporations were unable to pay their short-term debt. As a result, lots of corporations went bankrupt. For those that survived, they debt level multiplied and put them under high pressure. Corporate failures and threat of escalating liabilities drove their stock markets into free fall. So, a collapse in currencies value spread to stock market and finally to the economy.

Let's look at the financial position of the Asian countries now. The charts below showed the level of external debt and international reserve in 1996 and the latest figure

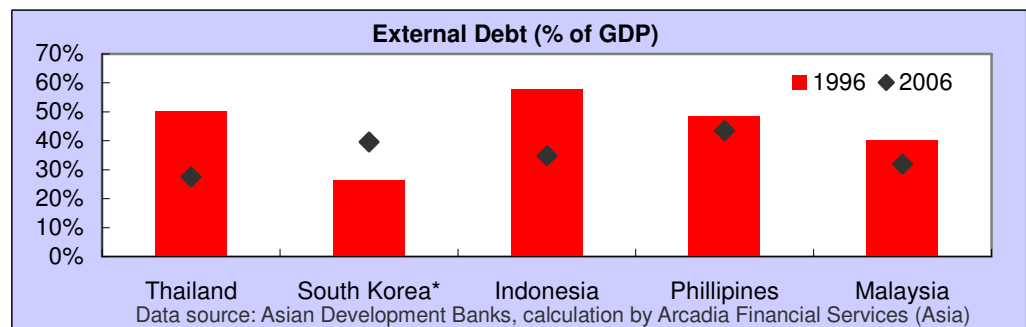


Chart 1: Selected Asian Countries external debt level

Remarks: \* - 2007 year end figure

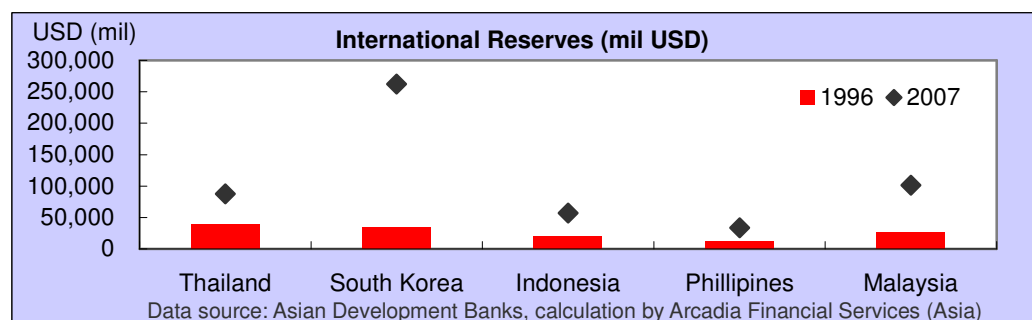


Chart 2: Selected Asian countries International reserve level

We can see that the Asian countries are in much stronger financial positions now. First, their external debt level is lower. Even if their currencies declines in value, it is unlikely that their debt level will jump to unmanageable level. Moreover, the Asian countries now hold an enormous international reserve. Compare with 1996, the amount of reserve for Thailand and Malaysia is more than doubled and South Korea has a seven-fold increase. Holding a large reserve helps to ensure that their governments have sufficient foreign currencies to meet their external debt payment needs. In other words, the risk for currencies depreciation turning into debt crisis is much lower now.

To sum up, public and private debt levels are much more manageable, and the central banks are holding a much bigger international reserves against the external debt. So, the environment is not one for financial crisis to develop and we expect the problem in Vietnam would be an isolated case this time.

Still, we must reiterate that Asian countries are still under pressure of surging inflation and exports slowdown. We maintain the negative outlook on the region.

#### **US: Negative**

Over the month of May, DJIA was down by 1.42%, S&P500 was up by 1.07% and NASDAQ was up by 4.55%. Economic data shown that US economy is worsening further, it is especially true for the labour market. US unemployment rate jumped in May and non-farm payroll had been declining for 5 consecutive months to May. Given the economic slowdown continues and it remains a threat to corporate earnings, we remain cautious on US equities.

#### **EU: Negative**

European markets generally went up with US. DAX was up by 2.13%, CAC gained 3.55% and FTSE100 moved down by 0.70%. European markets again followed the lead of US, again we do not think it will change anytime soon.

#### **Japan: Negative**

NIKKEI gone up another 3.53%. Resources prices pushed up the inflation rate in Japan and it seemed like Japan is coming out from deflation. However, the price increase is imported rather than developed from strong domestic demand. So, we do not think it indicates an improvement in Japanese economy and we remain negative on Japan market.

#### **China: Slightly negative**

HSCEI declined by 3.23% in May. Attempting to tighten liquidity and reining in inflation in the country, PBOC lifted the required reserve ratio by another 1% to 17%. It showed that the natural disasters happened recently did not move the policy focus of fighting inflation. As the tightening measures are reinforced and external environment deteriorating, we believe it will further pressure on Hong Kong stock markets as well as the Chinese enterprises.

#### **Hong Kong: Slightly negative**

HSI also lost 4.75% last month. Similar to the Chinese enterprises, Hong Kong market would be very much affected by external environment. It is not expected to start another bull run soon.

#### **Emerging Markets: Slightly negative**

So far this year, resources rich emerging countries e.g. Brazil and Russia had outperformed the resources importers such as the Asian countries. In May, Russia became the second major emerging market to make a new record high after sub-prime related crisis broke out. On the other hand, Brazilian equities market's bull rally was disrupted by interest rate increase and turned down a bit. Having a rich natural resources reserve helped Brazil and Russia to stand out from the other emerging markets. In fact, the strength of their equities market is very much linked to resources prices. Therefore, we prefer direct investment in resources, which provides better diversification from risk related to equities markets.

**Bonds: Slightly negative**

The major central banks publicly expressed their concerns about inflation and their policy focus had now shifted to taming inflation. Even the Fed, which was the most aggressive in cutting interest rate, has turned to a more hawkish stance against inflation. So, the chance for more interest rate cut is getting dimmer and dimmer. Market expectation shifted toward rate increment and it drove up yields on government debt. Although we still expect occasional fund flow into high quality bonds during shaky times in equities markets, it is not enough to keep bond prices up. Given that fighting inflation is primarily concerns of central banks and the economy is still slowing down, we believe inflation protected bonds provide good protection against rising inflation.

**Commodities: Positive**

Crude oil price continued with the seeming unstoppable surge. It has crossed the 130/barrel mark. Currently, crude oil price is very much driven by speculative fund flow. Although it has superior momentum for the time being, it is not uncommon that a sharp adjustment to come after short term exhaustive rally. So, we think investors may consider locking in profits as crude oil prices rallies. For gold, it is consolidating around USD 840 – 900 per ounce and we do not expect a near term break out.

**Hedge funds: Neutral**

Hedge funds had done well in May. The HFRX Global Hedge Fund Index was up by 1.44%. HFRX Distressed Securities Index is dropped by 0.21%. For the performance leaders, they are HFRX Equity Hedge Index, HFRX Convertible Arbitrage Index and HFRX Marco Index. Their monthly gains are 2.39%, 1.83% and 1.77% respectively.

**Advices for investors**

We maintain the negative view on equities, as slower economy shall pressure on corporate profits and share prices. Moreover, inflation concerns could weigh on bond prices. Our preference still stay with alternative investment, e.g. hedge funds and commodities, especially gold and agricultural products for inflation protection.

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