



Jul 2008

Accumulating assets in bear market.

Equities markets turned around in Oct 2007. The turnover was triggered by the massive write off among financial institutions on US sub prime related loans. Besides the sub prime problem, there are several other problems in fundamental factors e.g. global economic slowdown, rising inflation and tightening of monetary conditions around the world. These are structural problems and they are not expected to be solved in a short period of time. So, they shall pressure on global equities market in coming quarters. The current decline in equities markets is reflecting not only short-term problems, but some structural problems and it shall last some times. In other words, we are in a secular bear market.

Let first see where we are in this secular bear market.

We believe we have already gone through the first phase of the bear market, which was marked by the panic selling from Oct 2007 to Jan 2008. Currently, Hong Kong stock market is in the second phase. In the second phase, investors sobered from the panic selling and market focus shall return to fundamental factors e.g. corporate earnings, economic prospect and policy actions. Since we are still facing some structural problems as mentioned earlier, we think that the general direction of the market is heading downward.

After the second phase, the bear market still has a third phase. The typical condition in the third phase is that fundamental continues to deteriorate and share price fall slowly. Investors' sentiment often becomes very pessimistic at this stage. So, share price often declines to very cheap level and provides investors good chance to accumulate their assets. The key here would be doing it consistently and patiently, so regular investment would be suitable strategy to take advantage of it.

To conclude, we believe the equities market still have some way to go downward because economic growth slowdown, inflation threats are not expected to gone away anytime soon. So, for lump sum investment, we still favour commodities which is still in the bull market. But for regular savings, investors shall get prepared to take advantage of the bear market and accumulate valuation assets at low cost.

US: Negative

In June 2008, US stock indices made their biggest drop since 2002. DJIA fell by 10.19%, S&P500 lost 8.60% and NASDAQ also went down by 9.10%. The structural problems in US became more complicated and difficult to tackle as inflation rose. Housing, employment and consumer confidence all were deteriorating. On the other hand, inflation was driven up to 17 years high of 5% and core inflation also rose to 2.7%. In short, the US economic condition is still getting worse. For the stock market, it turned down again after the rebound in Mar.

EU: Negative

European markets also fell very significantly. DAX slumped by 9.56%, CAC dropped by 11.56% and FTSE100 fell by 6.93%. European countries are facing similar problems to US, inflation in Eurozone rose to 3.7% in May 2008 while industrial production declined 0.6%, the first time in 3 years. Thus, business environment in Europe is also deteriorating and stock market remained under significant pressure.

Japan: Negative

NIKKEI declined by 5.98%. NIKKEI had already declined by around one third from the peak in 2007 and it became relative resilient compare with other developed markets. However, Japanese economy still lacks internal drivers for growth. We do not have high hopes on its stock market.

China: Negative

HSCEI lost 13.51% in June. It showed the impact of major stock markets on Hong Kong listed companies again. Recently, some Chinese enterprises announced their profits would soar in the first half of 2008. It brought about a rally in their share prices. However, as inflation rises and external environment deteriorates, business environment in China is also getting more difficult. The rally is just expected to be another short rebound.

Hong Kong: Negative

HSI dropped 9.91% last month. Similar to China market, the rise in recent days is expected to be another brief rebound. Investors are not encouraged to chase in.

Emerging Markets: Negative

We remain negative about emerging countries stock markets. Inflation concerns became the focus of central banks as well as investors. Central banks around the world are responding by lifting their interest rates. The pressure for emerging markets is particularly high as food and energy prices make up a higher proportion of their consumer price index. Thereby, monetary policy is turning tighter in emerging markets. It became the pressure on their stock markets.

Bonds: Slightly negative

Inflation concerns finally turned into policy actions. This month, ECB became the first major central bank to lift interest rate in 2008. It has raised the repo rate by 0.25% to 4.25%. However, Chairman Trichet, cooled off the expectation for further interest rate rise by stating that they have no bias in future in interest rate action. It showed that ECB is facing the same dilemma as US Fed. The room for policy action is limited. So, neither aggressive easing nor rapid tightening is expected. Still, inflation and rising commodities prices remain a significant risk to bond investment.

Commodities: Positive

Once again, commodities headed up against falling stock market. Crude oil, gold prices and agricultural products all headed up in June. Crude oil gained on renewed concerns about threat of military conflicts in Middle East. Gold headed up again on concerns about threat to the financial status of US government due to solvency problems of Freddie Mac and Fannie Mae. Overall, we still think commodity is the sector that can help to protect investors from falling equities market.

Hedge funds: Neutral

Headline HFRX Global Hedge Fund Index lost 0.83% in June, it showed that hedge fund performance were going down as a class. There were only 2 strategy sub-indices, which made a gain, namely HFRX Marco Index and HFRX Equity Market Neutral Index. Their monthly gains were 3.25% and 1.02% respectively. Here we are in the middle of the year, let check out performance of different strategies in 2008.

Advices for investors

For lump sum investment, we continue to favour commodities investments, especially instruments that are not linked to equities markets e.g. physical commodities or futures markets.

For long term regular savings, bear market could be an opportunities to accumulate assets. What we suggest is to wait for the stock market to went through initial phase of the bear markets and gone through significant adjustment before starting to accumulate your assets.

Lastly, we would like to take this chance to invite you to our investment seminar about "Bear Market Strategy" on 26 July 2008 at 2:15pm. Mr Powell Cheung from Franklin Templeton and Our chief investment officer, Mr Timothy Lo and will share with you their insight in how to tackle with the current bear market. Please contact your financial consultant at Arcadia for more details or make reservations through telephone at 2114 8488 or email to contactus@arcadia-asia.com.

Important Notice:

The information contained within this document is for the information of prospective clients and existing clients of Arcadia Financial Services (Asia) Ltd (here after AFS) and/or Arcadia Asset Management (Asia) Ltd (here after AAM). The information is not intended to be a recommendation, offer or solicitation to buy products, securities or services. Products and securities described within this document are not applicable to all persons of all nationality, residence or domicile. Persons interested in making any investment or purchasing any products or securities described within this document should inform themselves as to the legal requirements in their country of nationality, residence or domicile.

Investment in securities carries risks. Past performance is not necessarily a guide to future investment performance. If there is any doubt, you should seek advice from your financial consultant before contemplating any investment.

The information contained within this document is believed to be correct and was obtained from sources believed to be reliable, but accuracy, timeliness or completeness cannot be guaranteed. AFS and AAM cannot be held responsible for any errors or omissions contained within this document or for any consequences arising from the use of this document or the information contained within it.

If you want to receive Arcadia Market Commentary or you have any comments to us, please send to us by email: servicing@arcadia-asia.com or contact us at below at no obligation. Information sent to us will be treated strictly confidential.

*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*