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## Accumulate assets in bear market

In our commentary last month, we suggest investors to take the opportunities in equities bear market for asset accumulation. You may want to ask, aren't we in the bear market now? So, does it mean we should start adding to our equities holdings?

The problem is stocks usually become over-priced in the late stage of the bull market. It would take some time for them to come back down to more reasonable level or to reach a bargain price. So, it is more advisable to wait at the sideline during the early days of the bear market and let the assets prices adjust before taking action.

But, how can investors know when to start putting money back into the equities markets? Our approach is to look at previous bear market performance and use it as a guideline for setting reference entry points.

Let's take Hong Kong market as an example. In the 2 previous bear markets ending 1998 and 2003, Hang Seng Index declined 61% and 54% from peak respectively. So, we can see that a 40-50% fall is not uncommon for Hong Kong market. For Arcadia, we shall set the trigger point higher than the magnitude of decline to start accumulating assets early. For Hong Kong, we would set the entry point at 37% fall from peak. This is also the reference for developed Asian countries. For other emerging markets, we have a higher percentage drop at 47% to trigger regular investment as less developed markets are more volatile and declines are often deeper.

Below are the reference entry points for the major emerging markets.

Market	Index	Previous peak	Target % drop	Reference entry point	Current level(1)
Hong Kong	HSI	31,958	37%	20,100	21,260
China	HSCEI	20,609	47%	10,900	11,170
Korea	KOSPI	2,085	37%	1,300	1,572
Singapore	Strait Times	3,906	37%	2,500	2,797
Taiwan	TAIEX Index	9,859	37%	6,200	7,196
India	BSE	21,206	47%	11,200	14,724
Russia	RTS	2,498	47%	1,300	1,785
Brazil	BOVASPA	73,920	47%	39,200	54,244
Malaysia	KL Composite	1,524	47%	800	1,095
Philippines	Manila Composite	3,896	47%	2,100	2,725
Indonesia	Jakarta Composite	28,38	47%	1,500	2,085
Thailand	SET	916	47%	500	707

(1) Current level as of 15 Aug 2008

(2) The index which have touched reference entry point is shown in red font.

The starting point above were reference level that help investors avoid jumping back in too early. It does not mean the stock market will bottom at those levels and skyrocket from there. It would likely struggle further for some time before underlying economy take hold and a new bull market is born.

Now we have a plan to handle the bear market. What's still needed are patience and consistency to follow the plan and weather the ups and downs in the accumulation period.

For current market conditions, USD gained strength on poor economic prospect in other major economies e.g. Europe, UK, Japan and Australia. It resulted in abrupt pull back in commodities prices and other major currencies. However, US housing market and labour

markets are still deteriorating and consumption is also clouded by tightening credit conditions. It would need a weaker dollar to boost external demand. We do not take the recent strength as the start of a last period of strong USD and do not change our view on commodities.

### **US: Negative**

In July, DJIA edged up by 0.19%, S&P500 was down by 0.99% and NASDAQ was up by 1.42%. Recently, the US equities market was cheered on by softening commodities prices. All 3 indices headed up on easing worries about inflation. However, when we look at the economic conditions and corporate earnings prospect. It is still worsening. Housing market, job market and industrial productions are all heading down. Financial institutions are threatening by charges and penalty related to ARS sales. In sum, fundamental factors shown no improvements and thereby, we think it is just another rebound in the bear market.

### **EU: Negative**

DAX moved up by 0.95%, CAC lost 0.96% and FTSE100 moved down by 3.65%. Latest economic data shown that global economic slowdown became more obvious. In the 2<sup>nd</sup> quarter of 2008, GDP in Euro zone shrank by 0.2%. Germany, the biggest member and growth engine of Euro zone reported a 0.5% drop in GDP in quarter on quarter comparison. Moreover, leading indicators showed that the economic prospect is not optimistic either. Both ZEW business expectations indicator and Ifo business expectation index made a deep dive in Jul 2008, Ifo business expectation index dropped to 90, lowest level since 2003 and ZEW business expectations indicators tumbled to -63.9, a 16 years low. Even though the market recovered a bit, it lacks material support from fundamentals.

### **Japan: Negative**

NIKKEI lost 0.78%. Japan made no exception to the slow down story. In the last quarter, GDP contracted by 2.4% on year on year comparison. Exports, the driver for Japanese economic growth, also came under fire as global economy slows down. Japanese exports slowed down significantly since beginning of the year and it reported the first year on year decline in June 2008. For Japan, its economy is worsening together with US and Europe. So, we do not expect good performance in Japanese equities market either.

### **China: Negative**

HSCEI climbed up by 5.01% in July. No policy action was taken to help the stock market. The Chinese government showed to investors that it would not take action for window dressing. Chinese A share market sunk again. Market sentiment had turned very pessimistic and mainland China and it pressured on Hong Kong market making it the laggard in recent rebound.

### **Hong Kong: Negative**

HSI gained 2.08% last month. Hong Kong market came under pressure as China A share market fell and disappointing corporate earnings. Now, Hang Seng Index is testing the low point 20,572 in previous panic selling formed in Mar 2008. It just takes another 500 points drop to hit our target entry level. For Hang Seng Chinese Enterprise Index, it had already hit the target entry level in Mar. So, Hong Kong and China may become the first target market to meet our criteria to trigger accumulation.

### **Emerging Markets: Negative**

Resources exporters had another sharp decline as commodities prices slumped. Russia fell 28% and Brazil lost 26% from the peaks formed in May 2008. It demonstrated the sensitiveness of their markets to commodities prices. We do expect better performance when commodities prices come back from the current drop. However, we still prefer the pure play approach.

### **Bonds: Neutral**

Lower energy prices and poor economic growth resulted in rapidly waning chance for further rate hikes in major developed countries e.g. Euro zone, Britain, Japan and Australia. It triggered fund flow out for these currencies to USD and USD rebound strongly in recent

days. The currencies risk for non-USD bonds had risen.

### **Commodities: Positive**

The pullback for commodities is sharp and general. In the last 4 weeks, Crude oil lost 20.12% and gold price dropped by 19.57% and agricultural were also losing grounds. The concerted retreat was the result of rebound of USD. Let's look at the fundamental factors. The supply and demand remains tight for crude oil and OPEC could trim output level in case demand eases on economic slowdown. These are supportive to oil prices. Also, US is facing tight credit conditions which threaten domestic demand. External demand would become important for US economy and it needs lower exchange rate to help exports. In sum, fundamental factors are still favourable for commodities and we maintain our preference for them.

### **Hedge funds: Neutral**

The HFRX Global Hedge Fund Index dropped another 2.82% in July. HFRX Merger Arbitrage Index was the only strategy sub index to report monthly gain. It edged up by 0.44%. On the down side, HFRX Marco Index lost 5.59%, HFRX Equity Hedge Index dropped 3.45% and HFRX Relative Value Arbitrage Index declined by 2.26%. Up to the end of July, HFRX Marco Index rose 7.72% on year to date basis and it was the best performing strategy sub index in 2008.

### **Advices for investors**

Rebound in USD led to general declines in major currencies as well as commodities prices. However, economic situation in US gave no support to long-term strength of USD. We believe the current strong rally is related to short covering of investors who had short USD before. As said before, fundamental factor remained supportive to oil prices and against stronger USD. We maintain our preference for commodities.

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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**