

## **MARKET REVIEW**

### **FEBRUARY 2010**

Asian markets were generally stronger in February, rebounding from the weakness during end January and the start of February. Notably, the Red Chips listed in Hong Kong as well as Thailand's SET and the Philippines's PCOMP rose by 4.8%, 4.0% and 3.9%, in US\$ terms, respectively. Taiwan's TWSE and Indonesia's JCI fell for the month of February.

During the month, the Dow Jones rose by 2.6%, while the Nasdaq followed with a stronger performance of 4.2% rise. The US dollar traded generally weaker against Asian currencies with the Filipino Peso gaining 0.8%. The Nikkei was flat vs the Dow Jones and only rose marginally by 0.7% in US\$ terms.

In our view, Asian markets are expected to remain volatile and choppy in the coming months. Over the last 12 months, markets have re-rated upwards to levels that price in a continued economic recovery but the global economy is recovering in fits and starts and lacks convincing evidence that secular uptrends are firmly in place. The tussle between what markets are expecting and what the real economy and corporate earnings is able to deliver could lead to sizeable share price gyrations with the occasional shock driving markets down.

Clearly, fears of Greece defaulting on their debt have receded, for now, following the success of their €5bn 10-year sovereign debt issuance on 4 March, thereby temporarily removing the overhang on equity markets in Europe as well as Asia. However, Greece's fiscal problems have yet to be fully resolved—there are two repayment tranches of about €8bn due each on 20 April and 19 May and a total of €54bn due for 2010. Despite this initial success, it remains unclear that Greece will be able to find a more permanent solution to its upcoming deadlines on interest servicing and principal repayments. The problems facing the Eurozone's peripheral economies of Greece, Italy, Portugal and Spain should linger given that Germany cannot, for domestic political reasons, be seen to be overly generous in aiding these weaker economies.

Within the region, there is also less to cheer about given that China has been resorting to measures, some of it administrative, in an attempt to cool down its economy. Effective February 25, PBOC hiked the reserve requirement ratio by another 50bps, following on from an earlier hike on January 12. Currently, large commercial banks are required to deposit 16.0% of deposits at the central bank and small banks 14.0%. The purpose is to manage domestic liquidity rather than tighten further. On the credit front, commercial banks extended Rmb1.39 tn of loans in January.

On the other hand, the US economy does provide some cheer to markets. Industrial production has been rising and provides clues that corporate spending should show signs of recovery. In addition, personal consumer expenditure, a lead indicator for US consumer spending has been rising. Although the housing market is not showing a strong recovery, the improvements for corporate and consumer spending gives us room for cheer.

Against this backdrop, as the year unfolds, we see two potential binary outcomes for Asian stock markets. Under the first scenario, the economy “muddles-through”, fuelled by low interest rates—although this is slowly rising—and a continuation of fiscal stimulus measures. In the muddle-through scenario, there are no large shocks to the global economy and stock markets remain range-bound with an upward bias while waiting for the economy to recover and for corporate earnings to catch up to market expectations. In this scenario, there will be opportunities to ride on sector and country plays as the environment for investing remains relatively free of major shocks.

Under the second scenario, unresolved, structural debt issues within the global economy start to manifest itself either as a sovereign debt crisis, an economic double dip outcome, stagflation (coming from a combination of rising commodity prices due to strong Asian demand but weak end-consumer demand from developed countries) or an unexpected currency crisis, leading to unexpected market shocks. In this second scenario, stock markets will be susceptible to large bouts of corrections where stocks across the region will be pulled down uniformly.

Given this outlook, we do not see the need to be very highly invested for now nor do we see these market conditions as being very conducive to taking excessive risks, particularly after a year of strong returns in 2009. For absolute return funds, we would be focussing on trying to generate outperformance without taking excessive risks.

As mentioned in earlier, stock picking and sector selection would be important, barring any major shocks. We have been lowering our equities exposure in recent weeks and would seek to opportunistically use the cash raised to reinvest in stocks that have declined to attractive levels. Countries that continue to offer relative value from a top down perspective include Thailand and China’s H-shares while we will continue to seek for value stocks in sectors that include early cyclicals like commodities, technology and financials for the play in economic recovery, oil & gas for the exposure to rising spending in this sector, infrastructure and building materials that benefit from the fiscal stimulus programmes of the various countries.

Source: Pheim Unit Trusts Bhd