

Be cautious but look to make a profit

Conventional wisdom holds that the slice of any portfolio put into mutual funds is going to be there for the long term.

However, smart investors also know that market volatility spells opportunity, so they are taking profits where appropriate and actively considering funds that reflect changing economic trends and are forecast to give consistently higher returns.

"It is not a time to panic, particularly if you are a medium to long-term investor," said Jon Dingley, managing director of TTG (HK). "But, in general, we recommend that our clients crystallise some of their profits gained from long-only equity funds over the past few years and increase exposure to certain alternative strategies or hedge funds."

While predicting further volatility and "plenty of it" in the next three to six months, Mr Dingley indicated that investors should take careful note of the potential downside risk of funds in which they were invested. They should make it a priority to review exposure and, if necessary, realign their portfolios. Doing this on a regular basis allowed them to maximise the chance of achieving absolute returns irrespective of the direction of markets.

He said certain investment themes now merited special attention. These included agriculture, water, consumer goods, infrastructure, Asian technology and, above all, China.

"There are some sectors we like, such as agriculture-related commodity funds," Mr Dingley said.

He noted that some people, well known in the international investment community, had already stated publicly that one of the next big trends would be the growth of agricultural funds.

"If you look at how the figures stack up, you can see why. Global warming is having an effect on the price of wheat and other commodities and, irrespective of what happens on stock markets, people need to eat."

The usual way for the average investor to access this sector is through a fund with exposure to an agricultural commodity index. The



Agricultural funds are seen as one of the next big trends. The usual way for investors to access this sector is through a fund with exposure to an agricultural commodity index. Photo: Bloomberg

Mutual funds are good for the long term but the volatile climate now means that there is quick money to be made, writes **John Cremer**

companies invested in might be suppliers of farm machinery, irrigation equipment or even chemicals and fertilisers.

Alternatively, it is possible to buy into a specialised hedge fund, which might deal predominantly in metals, energy and oil, but also have about 5 per cent of its holdings in agricultural commodities, trading coffee, sugar and wheat.

Typically, Mr Dingley explained, such funds were "a little more

exclusive", with a minimum investment of perhaps US\$30,000 or higher. "Generally speaking, they are globally focused. But it is no secret that China has massive demand and is already a big player in that regard."

He suggested that investors should also look for opportunities linked to the mainland's increasing need for water. Experts estimated that 70 per cent of the available supplies are already too polluted to

irrigate arable land, so concerted action would have to be taken.

"Clearly, they will have to spend on that, so it will benefit companies able to help in rectifying the problem," he said. The mainland's substantial reserves could afford to finance these projects and could no longer afford to postpone.

"From our perspective, we look at the markets of China and India, and how much the respective governments are committed to spending on infrastructure," Mr Dingley said. "That has to have an effect on the requirement for commodities and building materials."

He said that some funds had been set up to invest mainly in

companies specialising in the water filtration process and piping. This made it possible to give clients a small exposure in their overall portfolio as a first step towards involvement in the sector.

The increase in environmental awareness means that ecology funds are also gaining in popularity. These generally focus on companies in renewable energy and, to a certain extent, can provide a feel-good factor. However, Mr Dingley said that, for most investors, this only counted for so much.

"First and foremost the issue is how do these sectors stand up and do they eventually make money," he said.

Cindy Fu, head of investment for

the wealth management division of Standard Chartered Bank (Hong Kong), said that local investors now had mature expectations about mutual fund performance but should remain aware of new opportunities. She said that many people had been expecting a correction after the strong gains in equity markets in the first half of the year. The subprime crisis in the United States had little obvious impact on local investors, most of whom were focused on Asian and China funds.

"At the end of the day the economic data is still very strong in this part of the world, and the overall sentiment is good," Ms Fu said, adding that macroeconomic



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MANAGING DIRECTOR, TTG (HK)

forecasts indicated that heavier weighting towards China made good sense. "China is always there as the theme," she said. In recent weeks she had seen switching between funds rather than redemptions, as some investors sought to rebalance their portfolios.

As ever, diversification was the key, with something in each "pot".

However, in the present environment, she suggested considering bond funds paying monthly dividends, and thinking twice about certain higher-risk single-country funds, which might have trouble repeating rates of growth seen earlier in the year. "We don't encourage switching too often, but you should review your goals."

Volatility likely to be feature of markets for some time

Kelvin Yip

Investors are concerned about recent worldwide market volatility. What began with United States investors worrying about subprime mortgage woes led to a sharp downturn in global markets. Closer to home, the Hang Seng Index has not been spared. From July 24 to August 17, the Hang Seng Index fell 13.1 per cent.

While the sharp decline occurred in a short time, it is important to determine whether this was just a correction or a market slump which might drag on. The most recent correction happened in February as a sharp decline in the mainland market led to concerns. One key difference between a correction and a market slump lies in the duration. The table shows that corrections generally do not last long. The duration of a correction was three weeks on average and, usually, did not last beyond six to seven weeks, while some were as short as a week, such as the February correction. However, the economic fundamentals remain strong and the Hang Seng Index rebounded following the February correction.

From May 17, 2002 to April 25, 2003, the Hang Seng Index shed 29.8 per cent as a result of a slow global economy and Sars being investors' main concerns. The decline was even more severe from March 28, 2000 to September 21, 2001 as a result of the bursting of the tech bubble, and from August 7, 1997 to August 13, 1998 during the Asian financial crisis. The one time the market fell sharply in a relatively short time was from March 1, 2004 to May 17, 2004. The Hang Seng Index dropped 21.2 per cent because of interest rate rise concerns in the US.

We do not think a global recession is on the cards because the economic

growth factors that existed before these subprime-led corrections still exist. China and India are still major economic growth drivers for Asia. Domestically propelled consumption growth in Asia is still significant and trade in Asia is growing at a faster pace than trade with the US. If concerns over the subprime lending continue, with more hedge funds deciding to halt redemptions (due to the inability to price the underlying subprime loans), it is likely that volatility will continue in the short term. Even the US economy is more likely to have a soft landing this year rather than go into recession.

Holding on to investments which are still reasonably valued is the way to go. Markets that have corrected significantly – Hong Kong, South Korea and Taiwan – are more attractively valued after corrections. So, it makes sense to stay invested. European equities look attractive. This region was the most resilient of the regional markets we covered. The MSCI Europe Index dropped 5.5 per cent on a month-to-date basis (as at August 15) and the MSCI Asia ex-Japan Index was down 8.3 per cent during the same period. One reason for the resiliency would be the low

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valuation levels that the European equity market is trading at – 14.2 times and 13.1 times for 2007 and 2008 (data as at August 15). This makes Europe the cheapest among the regional markets we cover.

When valuations are low, downside risk is mitigated, as markets trading at lower price to earnings multiples become more resilient during downturns because there is value backing the market. Although the Indian and Chinese markets have been more resilient during the recent correction we think that the valuations have traded at a premium in these markets.

Having said that, the Hang Seng Index has risen from its recent lowest level on August 17. From August 17 to 22, the index rose 8.8 per cent. So, while this correction may have run its course, we expect to see some volatility. Our studies have shown that volatility will probably remain at least in the third quarter. Based on our analysis for the past 17 years (1989 to 2006), we found that August and September were the months where markets have not performed as well as the other calendar months.

We believe that for the investors who wish to reduce volatility of their portfolios they should consider including some bond funds. Bonds can help because they have a negative correlation with equities. During the sustained equity downturn between the end of 2000 and the end of 2002, the MSCI World Index, which we use as a proxy for global equities, retreated by 34.2 per cent. Bonds were more resilient. Represented by the European Federation of Financial Analysts Societies or EFFAS Bond Index, bonds were up 16.9 per cent.

Kelvin Yip is a research analyst at Fundsupermart.com

Hang Seng Index: corrections or slumps

	Start date	HSI	End date	HSI	%	Length of time
Correction	Jul 24, 07	23,473	Aug 17, 07	20,387	-13.1	3 weeks
Correction	Feb 22, 07	20,809	Mar 5, 07	18,665	-10.3	1 week
Correction	May 8, 06	17,302	Jun 13, 06	15,234	-12.0	6 weeks
Correction	Sept 29, 05	15,431	Oct 28, 05	14,216	-7.9	4 weeks
Slump	Mar 1, 04	13,919	May 17, 04	10,968	-21.2	10 weeks
Slump	May 17, 02	11,975	Apr 25, 03	8,409	-29.8	11 months
Correction	Jan 7, 02	11,893	Feb 7, 02	10,409	-12.5	4 weeks
Slump	Mar 28, 00	18,302	Sep 21, 01	8,934	-51.2	18 months
Correction	Jan 8, 99	10,723	Feb 10, 99	9,076	-15.4	4 weeks
Correction	Sep 13, 99	13,861	Oct 19, 99	12,134	-12.5	5 weeks
Correction	Jan 3, 00	17,369	Jan 25, 00	15,103	-13.0	3 weeks
Slump	Aug 7, 97	16,673	Aug 13, 98	6,660	-60.1	12 months

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SOURCE: FUNDSUPERMART.COM

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Source: Synovate PAX Q1 to Q4 '05 report

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