

# Q4 2009 Market Commentary



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The fourth quarter of 2009 defied most market experts and equities continued to power ahead. Even with our bullish stance for most of 2009, we were surprised at the performance in the fourth quarter. December in particular was a very rewarding month for our portfolios.

As we head into 2010, market sentiment indicators have turned decidedly bullish but in our judgement, are not yet at peak levels. Thus a further move higher will set markets up for a correction in the first quarter as investors begin to worry about potential interest rate hikes in late 2010.

As the global economic recovery gains momentum, governments will have to begin to withdraw the various stimulus measures now in place. In the short term, this may rattle investors' nerves leading to a correction in equities. However, we contend that governments will begin to unwind the stimulus only when the signs of economic recovery are firmly in place. We think that once investors make this adjustment, equities will rally as markets focus on continued improvement in the global economy.

As for China, our clients should not have been surprised at the exceptional strength reported in the Chinese economy for the month of December. Based on our frequent trips to China in 2009, we commented on the improving momentum that was visible on a monthly basis. The recovery in China has been nothing short of miraculous to the point now that the economy is at risk of overheating. While we do not agree at the moment that China is in a bubble, the Chinese authorities will have to begin the process of withdrawing the stimulus programs that have so far successfully been put in place.

This development will likely scare investors that China's recovery may run out of steam. However, we do not share that view. We believe that a big surprise in 2010 will be the emergence of domestic consumption in China as a key driver of the economy.

For far too long, the Chinese economy has been saddled with investors' concerns that it is too dependant on exports as a driver of growth. To be sure, exports are still important to the economy but from our read, total exports are now responsible for 24% of GDP, down from 33% in 2007 and heading lower. And in our view, domestic consumption is poised to take off. Credit Suisse has conducted an annual China consumer survey since 2004. Based on six years of data, the authors have observed six major themes in a report entitled 'Consumer Jump' January 8, 2010, which we have reprinted below:

## Macro/multi-sector

- 1) **Rich become richer:** Income in the high income group (top 10% households) grew much faster than the average.
- 2) **The poor and the middle are still much better off:** Even the income in the low income group is rising, particularly in the past two to three years, probably due to indirect benefits of improved farming profitability.
- 3) **Chinese are saving less:** The percentage of household income allocated to saving/investments dropped from 26% in 2004 survey to 12% in the 2009 survey, while spending on housing increased significantly.
- 4) **The property market is changing quickly:** Ownership structure has changed in the last few years, with more people living in rented property and property bought in the market. First-time home buyers might surpass upgrade demand as the major buyers in the market in the near future.
- 5) **Big ticket items, breaking out?** Car ownership rising, with consumers preparing a bigger budget for car purchases every year, despite car prices declining. The desire for larger LCD TVs increases every year.
- 6) **Foreign versus domestic, who will win the game?** Consumer confidence in domestic brands is generally rising. Foreign brands still have advantages in areas like big-ticket items, luxury goods and tech products, while domestic brands are dominating the consumer service sectors, such as telecom, internet and travel. They are even in the fast –moving consumer goods sector.

Our short term strategy is to gradually raise our cash weightings so that we may take advantage of any correction in markets. Despite our short term cautious stance, we remain bullish over the longer term for equity markets.

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