Q3 2009
Market Commentary

GALILEO

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Global equity markets have continued their recovery from grossly oversold levels set in March. Equity prices have certainly come a long way since then and a correction is overdue. Yet we expect any pullback to be relatively short and shallow. Abundant liquidity, investment funds parked on the sidelines, and growing signs of a global economic recovery, will all conspire to underpin this market. There still are simply too many investors waiting for a significant pullback. In our experience, when everyone is waiting for the same thing, it usually does not occur as expected.

In China, the economy grew by 8.9% Y/Y in Q3 2009, up from 7.9% in Q2 2009. However, the higher Q3 rate is deceptive due to easier Y/Y comparisons. Real GDP growth slowed to 2.4% Q/Q (9.9% annualized) in Q3 2009 from 4% Q/Q (16.9% annualized) in Q2 2009. We view this slowing as a positive event since the Q2 annualized growth rate of 16.9% is not sustainable. And the slowing (albeit to a still robust rate) reduces the odds that stimulus is removed any time soon.

We spent three weeks in China during September which is our third visit this year. One of the many insights we have acquired is that China's economy will actually be a beneficiary of this global recession. The leadership recognized the need to reduce dependency on exports and stimulate domestic consumption as a more sustainable economic model. In several cities, we witnessed numerous examples of a healthy and robust consumer sector at work. Golden Week (the national holidays during the first week of October in China), saw nationwide retail sales up 15% Y/Y. Over 800 retailers in Shanghai reported a 24% increase Y/Y. And consumer sentiment as measured by China Reality Research rose to 49.9 in September, up from 47.7 in August, continuing the recovery from the lows set late last year. As the standard of living rises, we expect to see domestic consumption playing a greater role in the economy.

For investors that remain sceptical that China's economy is not export-led, consider this quote from Andy Rothman, China Strategist at CLSA Securities; " The fact that China's GDP grew by 7.7% in the first nine months of the year, while exports were still extremely weak (the trade surplus was US$135.5bn, down by US$45.5bn YoY) illustrates that the mainland economy is not export-led. Net exports delivered a –47% contribution to GDP growth in the first three quarters, while final consumption accounted for 52% of growth and investment 95%."

Although the inflation trend in China has turned upward, it remains at a very low levels. Inflation may pick up in the second half of 2010, but for the moment, it is not an issue. While in the short-term, housing sales have slowed (due to higher prices and limited supply) and steel production is running ahead of demand, we remain bullish on the prospects for a continuing recovery in the Chinese economy.

We suspect that between now and year end, markets will be range bound. But we believe trends in the economy have turned for the better and as investors, we simply need patience.

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