



**M**arkets have been more volatile lately. The Dow Jones was down every month in the third quarter, ending with a total loss of 12% for the quarter in USD terms or a loss of 6.68% in SGD. During this period, there were 33 days in which the Index moved by more than 1%. On seven occasions, it moved by more than 3%. In fact, on one fateful day in August, the Dow fell 5.55%. These are some of the biggest declines since 2008. So much volatility naturally caused much anxiety among investors.

Some regulators are guessing that high-frequency trading may have contributed to the increased volatility. While it may be difficult for the average investor to imagine trades that can be executed within a millionth of a second, this phenomenon has become a part of stock trading. Short-selling, for the time being, has been banned in some European countries.

Other regulators think that exchange-traded funds may have something to do with it. What was once touted as a low-cost alternative for retail investors has now become part of the investment landscape, and the systemic risk that comes from these instruments is now a major cause for concern.

# THIRD QUARTER 2011 MARKET REPORT

BY **ISAAC LOW** CFA  
HEAD, INVESTMENT ADVISORY /  
PRINCIPAL PARTNER  
FIRST PRINCIPAL FINANCIAL



**In the wake of the collapse of Lehman Brothers and post-Iceland, it was thought that no country and no bank would be allowed to fail. Alas, as far as countries are concerned, it is no longer unthinkable. In some circles, it is believed that a Greek default is inevitable, having achieved the lowest credit rating possible for a country. It has now come down to who is to decide and what constitutes a default. The fear factor has spread to previously unaffected areas. Lately, the cost of credit default swaps has risen sharply, even for Australia. Hopefully, this will not lead to a credit crunch.**

As for bank failures, strong initiatives are underway to require banks to draft 'living wills', i.e., blueprints showing how they will be liquidated if they face collapse.

The troubles in Europe are now old news, so much so that it has lost its shock value. Portugal, for example, has already been downgraded to junk status. But then again, we may be surprised from time to time by the stories that surface. In Italy, it was seriously suggested that its market traders may have been under the influence of drugs, and should therefore be tested!



**Attention of the rating agencies were not entirely confined to Europe as they found time to downgrade the USA.**

This was after much huffing and puffing and feet-dragging by politicians to hammer out a compromise to increase the debt ceiling for the US government. Otherwise, the once mighty USA would not have been able to service some of its obligations. In fact, the finances of many US states are in dire straits. Some have begun to reduce the number of offences that require a jail sentence in order to put less demands on prison operations.

Depending on which side of the social divide you are on, the downgrade cost investors US\$1 trillion to be written off the stock markets. To the one in seven Americans on food stamps, it was probably just 'another day in paradise' for them investors. The number of Americans living in poverty increased to 46.2 million last year, the biggest number in at least half a century. 15 million are unemployed, and out of this 15 million, 4.4 million have been unemployed for more than a year. President Obama wants to tax the rich. The trouble is that it will be a while before they can decide who is considered rich in America.

To add to the many ills that plague America, it has now transpired that suspicions were afoot that some fund managers may have engaged in insider-trading just before the downgrade was announced. More and more, we read about the wrongdoings of various institutions and agencies. Hardly a week goes by without some allegation being made of fraud, conflicts of interest, wilful manipulation of data, withholding and destruction of material data, etc. At UBS, London-based rogue trader, Kwaku Adoboli, lost US\$2.3 billion for the bank. Are there any good guys left?

**On the currency front, the Swiss government intervened powerfully to cap the value of the Swiss Franc. Brazil and Japan faced similar dilemmas. American lawmakers once again turned their focus toward what they perceived as an under-valued Yuan, despite the fact that the Yuan has risen to its highest in 17 years against the USD. The noise coming out of the US does not bode well for global trade.**

**China, of course, marches to her own tune. While Europe muddles on and the US continues to be mired in deficit spending, China's five largest banks reported profits of \$57 billion for the first half of the year, surpassing the total of their 14 biggest rivals in Europe and the US. China continues to demonstrate support for Europe and is poised to play a bigger role in the crisis in the days ahead.**

In times like these, it should be borne in mind that pockets of opportunity exist. The story on gold has been going on for some time now. The recent pullback has caused some to confirm that the gold bubble has finally burst. Not too long ago, there was consensus that it should break US\$2,000 by year end. The sovereign debt crisis and the amount of liquidity generated in the global systems underpin the optimism in gold. It is probably wiser to bet on its uptrend than against it.

Other sectors have also fallen victim to bad news for some time now. Long-term investors may want to look at commodities, infrastructure and food and start taking small bites via dollar-cost averaging. Valuation has begun to appear attractive in some areas, in particular, in Asian and Emerging Market equities. The MSCI Emerging Markets index fell 23% in the third quarter of 2011.

**Huge profits are made in times of maximum pessimism. We may not be at the bottom yet but we are nearer to it than in the last quarter.**

**FIRST PRINCIPAL FINANCIAL PTE LTD**

Company Registration No. 199702254W

24 Raffles Place #14-02 Clifford Centre Singapore 048621

Tel: 6220 5333 Fax: 6220 5377

Email: [enquiry@firstprincipal.com](mailto:enquiry@firstprincipal.com)

[www.firstprincipal.com](http://www.firstprincipal.com)