

At the end of July, the Fund held a cash position representing 43.2% of total assets, up from 5.5% at the beginning of the month. In our view, because local retail investors increased their participation in the market over the course of the 2nd quarter, speculative flows increasingly dominated overall trading activity, stretching many concept-oriented, distressed balance sheet and banking sector stocks to unprecedented (read unreasonable) valuation levels. At the same time, foreign institutional investor participation in the market dropped to 22.7% by the end of the quarter, down from 38.2% at the end of the first quarter. Given these developments and the spectacular gains generated by the Fund during the 2nd quarter (up 84.8%), we felt it prudent to raise cash levels.

This conservative stance proved wise, after a series of negative news reports in the both the international and local press provided retail investors with an excuse to reduce exposure to the stock market and to lock in profits. This change in sentiment was reflected in a reduction in average daily trading volumes to Bt. 5.2 billion during the last week of July, down from Bt. 14.6 billion per day during the first week of the month. The following news items contributed to the sell-off:

1. War of words between mainland China and Taiwan regarding cross-straits relations;
2. Fears of further U.S. interest rate hikes;
3. The Thai government's decision to postpone (yet again) the release of details of an economic stimulus package;
4. Bank of Thailand report that NPLs for all banks and finance companies rose from 47.1% to 47.7% in May;
5. 2Q99 financial results for the banking sector which were (predictably) horrendous as banks meet the Bank of Thailand's provisioning requirements; and,
6. Rumours that Krung Thai Bank might be considering a capital reduction following a delay in a Bt. 108 billion capital increase from the government.

Despite the Fund's large weighting in cash, we continue to believe that both the economy and the market are on a solid recovery path. As such, the Fund still maintains positions in each of its core holdings, and is looking to increase exposures upon either a further pullback in the market or a return of positive investor sentiment. In our opinion, it's also prudent to hold cash since the Fund will be given the opportunity to subscribe to many pending, attractively-priced private placements in coming months.

Thailand continues to produce stronger economic figures. The manufacturing index for June grew 7.9%, the sixth consecutive monthly y-o-y increase, while capacity utilization increased to 59.9% from May's 58.7%. Consumption is also showing signs of growth as evidenced by the uptick in the composite index, the first time the index has recorded y-o-y growth in two years. The Bank of Thailand reported that higher sales of passenger cars, gasoline, residential electricity and essentials such as alcohol and cigarettes contributed to the rise. The CPI remained in negative territory for the second consecutive month in June with the average price level down 1.2% yoy, the first bout of deflation since at least the mid-1980s. Finally, exports continued to recover, growing 5.8% yoy, while imports (a coincident indicator of consumer confidence and a leading indicator of future export growth) increased 23.1%.

We continue to maintain both a medium-term and long-term bullish stance on the market. Nonetheless, we expect volatility in the market to remain at high levels, as investors assess the earnings potential of recovering Thai companies focused on the domestic economy. We also expect volatility to remain high within the export oriented sectors of the market, since investors are not convinced the Thai Baht will reverse its recent strength against the U.S. dollar. Outside of Thailand, we are also concerned about increasingly stretched valuation levels in the U.S. stock market and the effect a U.S. market correction would have on investment flows and valuations on the Thai market.