

## Election Cycle Unchanged Melody?



CHINA just completed 17<sup>th</sup> National Congress, which approved a new leadership team to run the country in the coming five years. The official Xinhua news agency reported that the party nominated 221 candidates to fill the 204 full seats on the Central Committee, meaning that 8.3% of those deemed eligible did not get a seat. Xinhua called this a "competitive election". The central message of the Congress is not change, but continuity. Nevertheless, financial market celebrated the event with benchmark indices setting the all-time highs. As such, financial markets can be analyzed in a simple manner. They go in line with the election cycle. In 2008, important elections will happen in the US and Taiwan. In the US, the four-year cycle of presidential elections appears to cast a shadow over the stock market. Investors usually get whacked in the two years following a presidential

election. But then they prosper in the following two years, when politicians and the stock markets start building up to the next election. The presidential election in the US seems to affect not just the US stock market, but stock markets around the globe. Indeed, US political cycle is important to the business cycle. US presidents apply tough economic medicine, such as budget cuts or higher taxes, in the first two years of their four-year term, while there is still plenty of time for voters to forget about the pain before the next election. Then, by their third year in office, they switch to more accommodative measures — perhaps cutting taxes, or launching public works projects — to keep unemployment low and voters happy. There seems to be happening now although the US economy is suffering from subprime crisis.

In Taiwan, however, the election effect was not applicable. Since Chen came to power in 2000, the TAIEX index has been the worst performer of 90 major stock indices tracked by Bloomberg. Chen's combative attitude toward China also contributed to the TAIEX's 17% slide in US dollar terms in the past seven years. Chen steps down in May 2008. The election will pit the Democratic Progressive Party's Frank Hsieh against former Chinese Nationalist Party chairman Ma Ying-jeou. Whatsoever, we are going to see a new direction in Taiwan whether Hsieh or Ma becomes the next president. Will election cycle happen in Taiwan now? By the way, TAIEX index has risen by 20% since the beginning of 2007. **E**

## Microscope

Analyses of price data for the S&P500 Index from 1942 to 2003 suggest that a potentially lucrative investment strategy would have included buying on October 1 of the 2<sup>nd</sup> year of the presidential election term and selling out on December 31 of year four. This simple strategy would have sidestepped practically all down markets for the last 60 years. For the most part, bear markets have historically occurred during the first or second years of presidential terms. (A bear market is defined here as the Index's decline approximately 15% or more over a period of one to three years, while a bull market is an environment of consistently rising prices.) It was found that no bear markets of this magnitude have occurred during an election year for the time covered. (Data on the separate sheet)

It is also apparent that markets are subject to change from time to time because of unforeseen macro events. As such, some cycles have been shorter and some longer than the norm. Remember that there are no guarantees! Now that many people are studying the election cycle, it's possible that the cycle's impact on the stock market will fade. **E**

### MARKET BRIEFING

#### YTD % (local curr)

<b>US DJ</b>	13,522 (+8.5%)
<b>Nasdaq</b>	2,725 (+12.8%)
<b>Euro Stoxx 50</b>	4,411 (+7.1%)
<b>HSI</b>	29,465 (+47.6%)
<b>Japan NK225</b>	16,814 (-4.4%)
<b>China Shanghai Composite</b>	5,818 (+117.5%)
<b>Singapore</b>	3,747 (+25.5%)
<b>India BSE30</b>	17,559 (+27.4%)
<b>Brazil BOVESPA</b>	60,894 (+36.9%)
<b>Aus All Ord</b>	6,723 (+19.1%)
<b>US-10yr Bond Yield</b>	4.4%

As at 19/10/07

## Insight: "Succession Planning"

With regard to estate planning, many people decide how property should be distributed at death, but it also includes techniques to build the estate during life and, for small business owners, the operation of the business, including passing that business on to the next generation. Most young families start with a modest estate but have major commitments to dependents. It is often said that these families are the ones most in need of estate planning. Their modest estate must provide for dependents should either or both parents die. Their concerns should be determining who receives the property in the

estate, the administration of the estate, and providing for the care of children. Younger persons also are concerned about increasing their estates to provide for dependents and seeing that property generates income during their lifetimes to supplement the income from their labor. To succeed a partnership business, life insurance is usually adopted to help transfer one partner's interest to the other partners if that partner dies. Various arrangements can be used. In a cross-purchase agreement, each partner owns a policy on each of the other partners, pays the premiums, and names himself or herself as beneficiary. When a partner dies, the remaining partners will have sufficient funds to purchase the deceased partner's share of the business. Succession planning decisions involve complex questions of law, tax, and business planning. **E**

## A-Z Financial Tools

Derivatives are financial instruments whose value is derived from the value of something else. The main use of derivatives is to reduce risk for one party while offering the potential for a high return to another. Warrants and futures are common examples for speculation while others like institutional investors issue them to hedge the adverse movement of their underlying assets. **E**



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