


“Tsunami” Warning – Commodity Inflation



Microscope

Traditional inflation-hedged vehicles include real estate, precious metals and crude oil. A quick comparison shows that oil, for example, has been an excellent hedge against inflation a 37-year compounded return of 8.5%. Real estate (in the US), meanwhile, has returned 6.15% over that same span since 1970. Amid the subprime contagion, global money supply is growing at approximately 15%, far above the production rates of most commodities, especially agricultural commodities. Estimates from the Food and Agricultural Policy Research Institute (FAPRI) suggest the supply/demand balance will remain tight for the foreseeable future.

Prices should remain elevated as productivity struggles to keep up with surging demand. According to FAPRI, prices of course grains (corn, sorghum and barley) should remain 50% above their 10 year average until at least 2016/17. In the very near future, however, owning agricultural commodities may be broadly viewed as an excellent hedge against inflation and a necessary component of a well diversified portfolio. 

WHEAT rose above \$10 a bushel for the first time and soybean and corn prices surged, fueling inflation that's threatening to derail global growth, according to Bloomberg. Food companies such as Kellogg Co. and General Mills Inc. have raised prices because of higher wheat costs, which are stoking inflation and making it more difficult for the world's central bankers to lower interest rates. In general, the stock market should do well under conditions of strong economic growth and low inflation. There have been many times in the past when strong economic performance propelled higher stock prices. The 1920s, the 1950s and the 1980s are classic examples. In the Reagan years, stocks and bonds rallied sharply in response to higher economic growth rates and job creation. Now, the risk of growing inflationary pressure may hurt the stock markets eventually as an artificial recovery created

primarily by "easy credit" by the government, due to high federal deficits and an expanding money supply. According to recent statistics, the US consumer prices rose the most in more than two years last month, reinforcing the Federal Reserve's concern that inflation will erode confidence in the economy. The consumer price index increased 0.8% in November, up from 0.3% the previous month. Moreover, inflation in Europe last month rose at its fastest annual pace since May 2001, increasing by 3.1% as food costs soared. Under normal circumstances the persistently high level of inflation since 1998 would long ago have caused the consumers of goods and services to experience a substantial loss of purchasing power and this loss of purchasing power would have pushed interest rates to much higher levels. Higher interest rates would in turn, have

caused a global contraction in stock market price/earnings ratios. During the last decade, however, the tremendous upward pressure that would normally have been seen long ago in the prices of goods and services in response to rampant inflation has been largely offset by a huge increase deflationary export from emerging markets. Now, the major production centre, China, faces rising cost of materials and most of the commodities too. The downward pressure on prices due to the globalization of manufacturing is, in reality, an inflationary force because by helping to keep the effects of inflation under wraps it creates the conditions under which much more inflation becomes possible. So, how can we hedge the inflationary pressure? 

MARKET BRIEFING


YTD % (local curr)

US DJ	13,339 (+7.0%)
Nasdaq	2,635 (+9.1%)
Euro Stoxx 50	4,384.65 (+6.4%)
HSI	27,563 (+38.1%)
Japan NK225	15,514 (-9.9%)
China Shanghai Composite	5,007 (+87.2%)
Singapore	3,466 (+16.1%)
India BSE30	20,030 (+45.3%)
Brazil BOVESPA	62,444 (+40.4%)
Aus All Ord	6,556 (+14.5%)
US-10yr Bond Yield	4.21%


As at 14/12/07

Insight: “Mortgage Planning”

In many countries it is normal for home purchases to be funded by a mortgage. Consumers may plan for their mortgage plans before making a purchase decision. The critical issues involved should be the affordability of the mortgage repayment as well as the effective cost during the mortgage duration. Commonly, many financial institutions offer adjustable rate mortgage. An adjustable rate mortgage is a mortgage loan where the interest rate on the note is periodically adjusted based on a variety of indexes, e.g. the Hong Kong Interbank Offered Rate. A few lenders use their own cost of funds as an index, rather than

using other indexes. This is done to ensure a steady margin for the lender, whose own cost of funding will usually be related to the index. Consequently, payments made by the borrower may change over time with the changing interest rate (alternatively, the term of the loan may change). This is not to be confused with the graduated payment mortgage, which offers changing payment amounts but a fixed interest rate. Other forms of mortgage loan include balloon payment mortgage. Adjustable rates transfer part of the interest rate risk from the lender to the borrower. The borrower benefits if the interest rate falls and loses out if interest rates rise. Yet, this difference is likely founded on the expectations of increases in the short term interest rate, hence the risk over many periods. 

A-Z Financial Tools

HEDGE FUND is a fund that can take both long and short positions, use arbitrage, buy and sell undervalued securities, trade options or bonds, and invest in almost any opportunity in any market. The primary aim of most hedge funds is to reduce volatility and risk while attempting to preserve capital and deliver positive returns under all market conditions. 



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