

Europe: Turnaround?



European stocks and Euro rebounded last week. European stocks rose for a fourth week as concern about the region's sovereign debt crisis waned. The Stoxx Europe 600 Index gained 2.4% to 255.5, the highest closing level since May 13 and the longest streak of weekly gains since April. The benchmark gauge has rebounded 10% from its 2010 low on May 25 after concern about levels of government debt in Europe pushed the index to its cheapest level relative to earnings in more than a year, according to Bloomberg. It seems that global investors are feeling more hopeful about the outlook for Europe's stocks. Especially, a Spanish bond auction June 17 eased concern that the nation will struggle to finance looming debt maturities. Spain sold 3.5 billion euros (\$4.3 billion) of 10-year and 30-year bonds, the maximum set for the auction. On the other hand, Britain posted a smaller fiscal deficit in May than

economists forecast as growth lifted tax receipts, providing a boost for finance minister before his June 22 budget. In addition, European Union leaders agreed June 17 to disclose how banks perform on stress tests, seeking to show investors that the financial system can withstand shocks. The decision came after Spanish officials unexpectedly pledged to publish results on individual banks, the first European government to do so. However, sovereign rating downgrades have eroded confidence in the balance sheets of the banks, most of which own government bonds. This, together with higher borrowing costs for fiscally challenged countries, has raised funding costs for banks in the interbank market and in the capital markets. The EU decision comes more than a year after the US released the results of stress tests it carried out on 19

financial institutions. Although it is expected the debt-ridden financial system will face pressure, the disclosure should give the market more confidence that the leaders are not hiding anything. Nevertheless, the number of investors forecasting the global economy to strengthen in the next 12 months fell, according to a Merrill Lynch survey of portfolio managers who together manage about \$606 billion. They increased their reserves of cash in June to the highest level in more than a year and continued to reduce their holdings in global equities to levels not seen since early 2009, the survey showed. Will the recent rebound disappear soon? Now, the markets are really worried about economic growth. By the end of the year, central banks will be back peddling. We probably need another dosing of stimulus. **IB**

Microscope

European Central Bank Governing Council member Axel Weber said future stress tests in the banking industry will be more comprehensive than today's evaluations and may include government bonds. It is expected that EU states should also provide a backstop if adverse scenarios materialize. The cost of providing that backstop may still fuel concern among investors that already indebted governments were taking on too much additional borrowing. On the other hand, former Federal Reserve Chairman Alan Greenspan said the US may soon face higher borrowing costs on its swelling debt and called for a tectonic shift in fiscal policy to contain borrowing, according to Bloomberg. He said perceptions of a large US borrowing capacity were misleading and current long-term bond yields were masking America's debt challenge. He emphasized that long-term rate increases can emerge with unexpected suddenness, like the 4 percentage point surge over four months in 1979-80. Nevertheless, US economy will keep expanding in the second half of the year without stoking inflation or generating many jobs, reinforcing the Federal Reserve's low-interest-rate policy. **IB**

MARKET BRIEFING

YTD % (local curr)

US DJ	10,450 (0.2%)
Nasdaq	2,309 (1.8%)
Euro Stoxx 50	2,737 (-7.7%)
HSI	20,286 (-7.3%)
Japan NK225	9,995 (-5.2%)
China Shanghai Composite	2,513 (-23.3%)
Singapore	2,833 (-2.2%)
India BSE30	17,570 (0.6%)
Brazil BOVESPA	64,437 (-6.1%)
Aus All Ord	4,574 (-6.3%)
US-10yr Bond	Yield 3.22%

As at 18/06/10

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 finding 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. **IB**

Financial "In & Out"

IN: High yield currencies, including AUD and NZD will continue their bull run amid the optimism that China's economic growth remains intact and risk appetite of investors is increasing.

OUT: USD will face profit-taking pressure in recent bull run due to concerns over her debt level and the slow economic growth in the coming year. **IB**



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