


Global Recession?



Microscope

Statistically speaking, stockmarkets this year might not do well according to the “January effect”. January returns have predictive power for market returns over the next 11 months, according to the Journal of Financial Economics, September Issue of 2006. It was found that the effect persisted after allowing for factors like business cycle variables and shifts in investor sentiment. On average, if stocks had a positive January, they returned on average about 14% during the next 11 months. If January was negative, they lost nearly 4% during the rest of the year. With regard to January as a reliable predictor for the rest of the year, however, there is no clear answer. However, the other important signal did not appear yet – inverted yield curve. In the past, the longer and deeper the yield curve is inverted, the more meaningful a slowdown we are likely to get. Based on the yield curve alone, a recession is a 40-50% possibility. Other factors move that up to 60%. While the treasury yield curve is now an upward shape, the risk of recession might be around the corner only. In case the Fed is too cautious to cut rate, the recession will come true soon. 

The US Federal Reserve’s emergency interest-rate cut of 75 basis points last week, which was the largest in the two decades that it has been the principal tool of policy makers, seemed to make sense amid the current fragile sentiment. Although some analysts argued that this rate-cut move increased the moral hazard or it was indeed misled by the large scale sell-off made by SocGen Rogue trader whose activities were disclosed afterwards, many investors supported this move. It was mentioned in our 1st Issue of Insider in September that global economic growth looked likely to slow markedly in the months ahead. Now, the US economy may be near recession; other countries might not be far behind. Japan, Britain, Spain and Singapore, which together represent about 12% of the world economy, are vulnerable as fallout from the US worsening economy. Even emerging markets, including China, are likely to suffer as

exports to the US wane, according to Bloomberg. Global recession doesn’t require a contraction in output, which rarely happens. Economists at the International Monetary Fund say it would take a slowdown in global growth to 3% or less. Ahead of the negative news from financial sectors, some form of global recession is inevitable. The contagion from the US, which according to the IMF represents about 21% of the global economy, is spreading via multiple channels. Less spending by consumers and companies in the US reduces demand for imported goods. Credit costs have been pushed up following the meltdown of the subprime-mortgage market. These forced European and Asian banks to write down billions of dollars in holdings. On the other hand, the European economy is starting to suffer collateral damage from the subprime mortgage

default. Banks in this region are making borrowing harder, industrial production is shrinking and investor confidence is waning just as the US skirts recession. With the euro’s appreciation to a record, economists are betting the European Central Bank will be forced to lower interest rates, according to Bloomberg. However, the ECB has so far refused to follow the Federal Reserve and the Bank of England in lowering borrowing costs, arguing that inflation pressures are too strong. In fact, Europe’s manufacturing and services industries probably expanded at the slowest pace since June 2005 and German business confidence fell to the lowest in two years, according to surveys of economists by Bloomberg.



MARKET BRIEFING

YTD % (local curr)


US DJ	12,207 (-8%)
Nasdaq	2,326 (-12.3%)
Euro Stoxx 50	3,777 (-14.2%)
HSI	25,122 (-9.7%)
Japan NK225	13,629 (-11%)
China Shanghai Composite	4,761 (-9.5%)
Singapore	3,159 (-8.8%)
India BSE30	18,361 (-9.5%)
Brazil BOVESPA	57,463 (-10.1%)
Aus All Ord	5,886 (-7.6%)
US-10yr Bond	Yield 3.56%

As at 18/01/08


Insight:

“Investment Risk Management”

Many people say they can switch out their risky asset to reduce investment risk due to price fluctuation. This idea is right to the certain extent. But whether we stay or leave, they are still there. They like the very oxygen that we breathe, and remain necessary in the world of portfolio management affairs. To achieve a successful investment management, whether or not we choose to accept it, we should realize and manage this risk. For simplicity, we have two rules to do this. First, prior to engaging in market activity, it is important to take a careful study of everything from your investment objectives, have a

plan and stick to it. For example, you have a savings plan for a retirement 15 years later, what you choose should be involved in market risk so as to achieve the long term capital growth. If you reallocate your portfolio, you should ask whether it is in line with your goals along this horizon. Secondly, portfolio theory teaches that we can decrease the uncertainty of a portfolio without sacrificing expected return by diversifying over a wide range of assets and asset classes. Some people think that this principle can also be used in the time dimension. They argue that if you invest for a long enough time, good and bad returns tend to even out or cancel each other out, and hence time diversifies a portfolio in much the same way that investing in multiple assets and asset classes diversifies a portfolio. It is called a mean reversion. 

A-Z Financial Tools

KEY PERSON INSURANCE is insurance on the life or health of a key individual whose services are essential to the continuing success of a business and whose death or disability could cause the firm a substantial financial loss. This is also credit management since, in case the key person dies, the proceeds to the company will enhance credit. 



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