

Risk of Rising Inflationary Pressure



Capital markets were full of fear two months ago when investors were afraid of the upcoming recession. While the market capitalization of the 1,933 companies in the MSCI World Index was still down about \$712 billion in 2008, the losses narrowed from \$4.49 trillion in March. Valuations rose as investors bet profits would increase. The S&P 500 trades at 23.8 times the reported earnings of companies in the index, the highest since December 2003, according to data compiled by Bloomberg. Price-to-earnings ratios of the MSCI World indexes rose more than 15% after dropping in January to the lowest levels since Bloomberg began tracking the data in 1998. Energy and raw-materials companies led the rally in global stocks since March as crude oil surpassed \$120 a barrel and steel-sheet prices in America rose to a record \$850 a ton. Now, the focus of the investors is shifting gradually from recession to inflation.

Bloomberg quoted the monthly survey by the University of Michigan as saying that US consumers expected prices to rise 5.2% over the next 12 months, the most pessimistic they have been since 1982. Treasury Inflation Protected Securities, or TIPS, also implied inflation rate of about 2.9% by January, in line with its average of 3.1% over the last 20 years. Although the rate implied in the prices was lower than that of the market forecast, the record import prices in the US and rising commodities would lift prices of goods besides just food and fuel, meaning traders might have been underestimating future inflation and TIPS were a bargain. Previously, the public and the TIPS were also at odds in June 2007, with consumers projecting 3.4% inflation and TIPS forecasting a 1.48%. Finally, consumers were right that inflation has averaged 4.1% over a year,

according to Bloomberg. The last time the two groups were in agreement was April 2006. Households surveyed by the University of Michigan that month forecast 3.3% inflation for the year, versus traders' 3.28% projection. Both projections were too high, as prices rose 2.6% through April 2007. What we are certain now is that the US drivers pay a record \$56.25 on average each time they fill their tanks, according to figures provided by AAA, the largest US motorist organization. Energy makes up 9.7% of the consumer price index, and commodities as a category comprise 41%, behind only services such as housing and medical care. Accordingly, the inflationary pressure is still high right now amid slowing economy. **E**

Microscope

Inflation-linked securities market originated in the UK in 1981, followed chronologically by Australia, Canada, Sweden, the U.S., France and Italy. The US Treasury has been issuing Treasury Inflation-Protected Securities (TIPS) since 1997. TIPS provide investors with protection against inflation. The principal of a TIPS increases with inflation and decreases with deflation, as measured by the Consumer Price Index. The global market represents approximately US \$500 billion in market value, including both government and corporate issuers. Today, investors in TIPS include central banks, asset managers, corporations, insurance companies, pension and endowment funds, and hedge funds. Technically speaking, there is inflation adjustments on TIPS, which can remove the uncertainty associated with inflation risk, so TIPS tend to be less volatile than nominal bonds and significantly less volatile than equities. Because of their lower volatility, TIPS can serve as a lower-risk alternative to nominal bonds, providing the potential for enhanced capital preservation in a portfolio containing riskier asset classes. **E**

MARKET BRIEFING

YTD % (local curr)

US DJ	12,986 (-2.1%)
Nasdaq	2,528 (-4.7%)
Euro Stoxx 50	3,862 (-12.2%)
HSI	25,618 (-7.9%)
Japan NK225	14,219 (-7.1%)
China Shanghai Composite	3,624 (-31.1%)
Singapore	3,241 (-6.5%)
India BSE30	17,434 (-14.1%)
Brazil BOVESPA	72,766 (+13.9%)
Aus All Ord	6,006 (-6.5%)
US-10yr Bond	Yield 3.83%

As at 16/05/08

Insight:

“Fund Performance Measurement”

To measure fund performance, it is usual practice to measure the performance of each fund against given indices and peer groups over various time periods. In a typical case, the calculation would be made every quarter and would show a percentage change compared with the prior quarter, say, total return in US dollars. Generally speaking, it is probably appropriate for an investment firm to persuade its clients to assess performance over longer periods, e.g., 3 to 5 years to smooth out very short term fluctuations in performance and the influence of the business cycle. Beside the relative return performance measurement, we

would also integrate other fund elements, such as the measure of risk taken. Several other aspects are also part of performance measurement, like evaluating if managers have succeeded in reaching their objectives and if their return was sufficiently high to reward the risks taken. On the other hand, many investors will look at the total return they earn over an investment. A fund's total return is the annual amount your investment changes in value, plus any distributions, divided by the initial investment. Of course, if additional purchases are made, or some shares are redeemed, this will affect investors' total return. When considering total return it is important to remember that two people invested in the same fund can have different total returns, depending on when they each invested. **E**

A-Z Financial Tools

Short Interest Ratio is the number of shares of a security that investors have sold short divided by average daily volume of the security. When people short, they may be pessimistic about the security's future performance. However, some would interpret a high short ratio as an indicator that there will be some buying pressure on the security that would increase its price. **E**



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