


Credit Crunch – How long will it last?




Microscope

The global dimension of the current crisis is not new as this is similar to that of the crash of 1929. While each financial crisis no doubt is distinct, they also share striking similarities, in the run-up of asset prices, in debt accumulation, in growth patterns, and in current account deficits. This time, the property bubbles finally burst two years ago. Those financial institutions leveraged such kind of assets, leading to today's crisis. In fact, the majority of historical crises are preceded by financial liberalization, such as securitization of debt this time. During the 1970s, the US banking system stood as an intermediary between oil-exporter surpluses and emerging market borrowers in Latin America and elsewhere. It is true that this time, a large volume of petro-dollars are again flowing into the United States, but many emerging markets have been running current account surpluses, lending rather than borrowing. Over a trillion dollars was channeled into the sub-prime mortgage market, which is comprised of the poorest and least credit worth borrowers within the United States. The final claimant is different, but in many ways, the mechanism is the same. 

Yesterday, "Credit Crunch" chocolates were seen for sale in Selfridges department store in London. Stocks around the globe tumbled for a fifth straight session on Tuesday. US stocks fell, sending the Standard & Poor's 500 Index below 1,000 for the first time since 2003, on speculation banks and real-estate companies are running short of money as the credit crisis worsens. The S&P 500 slid 5.7% to 996.23, extending its 2008 tumble to 32% in the market's worst yearly slump since 1937. The Dow Jones Industrial Average dropped 5.1% to 9,447.11, giving it a 29% retreat in 2008 that would also be the worst in 71 years. Now, the \$700 billion bailout package is passed but the market sentiment is still fragile. Federal Reserve Chairman Ben Bernanke on Tuesday signaled a readiness to lower US interest rates in a dramatic shift to support an economy battered by a financial crisis of "historic dimension",

according to Reuters. In fact, the outlook for inflation, while still uncertain, has improved somewhat as oil and other commodity prices have eased. In opening the door to rate cuts, Bernanke was departing from the view he and other Fed officials had expressed until recently that lower rates would likely have little effect in boosting economic activity while credit markets are frozen. The Fed cut interbank lending rates to 2% in seven steps between mid-September of last year and the end of April in a bid to put a floor under the economy. Since then, the central bank has focused on cash auctions and loans of ultra-safe Treasury securities to unlock credit markets. The Fed's efforts at restoring credit flows by pumping hundreds of billions of dollars into the financial system have become increasingly frequent and aggressive. Earlier on Tuesday, the Fed announced a

plan to buy an unspecified amount of commercial paper to ensure this common channel of short-term corporate lending remains open. Bernanke's remarks indicate the central bank's record loans to unblock credit markets are insufficient to prevent a deeper economic downturn. Investors increased bets the Fed will cut its main rate by as much as three-quarters of a point this month after premiums on loans between banks climbed to a record. As a matter of fact, minutes of the Federal Open Market Committee's September 16 meeting showed that some officials then saw a need for a rate cut should there be a "significant worsening of the growth outlook." Rate-cut can undoubtedly restore confidence in financial markets. 

MARKET BRIEFING

YTD % (local curr)


US DJ	10,325 (-22.2%)
Nasdaq	1,947 (-26.6%)
Euro Stoxx 50	3,113 (-29.2%)
HSI	17,682 (-36.4%)
Japan NK225	10,938 (-28.5%)
China Shanghai Composite	2,293 (-56.4%)
Singapore	2,297 (-33.7%)
India BSE30	12,526 (-38.3%)
Brazil BOVESPA	44,517 (-30.3%)
Aus All Ord	4,702 (-26.8%)
US-10yr Bond	Yield 3.6%

As at 03/10/08

Insight:


"Investment Risk Management"

It is well understood that when you invest, you should take certain risks. With insured bank deposit, you still face inflation risk, which means that you may not earn enough over time to keep pace with the increasing cost of living. With investments that aren't insured, such as stocks and bonds, you face the risk that you might lose money. Just because you take investment risks doesn't mean you can't exert some control over what happens to the money you invest. In fact, the opposite is true. If you know the types of risks you might face, make choices about those you are willing to take, and understand how to build and balance your

portfolio to offset potential problems, you are managing investment risk to your advantage. In fact, the major risk is "fear and greed". Sometimes, investors are too greedy to sell at market tops and sell at market bottoms for fear of losing more. Therefore, if we make right investment decision, risk can be managed. When you purchase an investment you expect to appreciate above the current market price, you're actually going against the market. You believe the market has improperly valued the investment. If the majority of the market believed the security was worth more, it would be trading at a higher price. The risk-return trade off is a single stock position can appreciate substantially or become worthless. A diversified portfolio can minimize both extremes. 

A-Z Financial Tools

Collateralized Bond Obligation (CBO)

is a kind of investment-grade bond backed by a collection of junk bonds with different levels of risk, called tiers, that are determined by the quality of junk bond involved. CBOs backed by highly risky junk bonds receive higher interest rates than other CBOs. Investors should study the inherent risk before investing. 



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