

## Europe – the Era of Renaissance

It was widely expected that the onset of a recession in Europe will force the European Central Bank (ECB) and the Bank of England (BOE) to lower their benchmark rates on November 6 by a half-point to 3.25% and 4% respectively, according to Bloomberg. In addition, European interest rates will drop at a historic pace as central banks try to limit economic damage from the global financial crisis. The ECB and the BOE will slash their benchmark rates to 2.5% by the middle of next year, lowering them by a total of 1.75 and 2.5 percentage points respectively, according to median forecasts in two surveys by Bloomberg. Central banks around the world are cutting borrowing costs aggressively as the financial crisis that started with the U.S. housing slump threatens to tip the global economy into recession. The Federal Reserve last week cut its benchmark to 1% from 1.5% and signaled it's ready to take rates to the lowest

level on record. China and Japan also reduced rates last week. If economists' forecasts prove accurate, the ECB will lower rates at the fastest pace since its creation in 1999 while the Bank of England's cuts will be the quickest and deepest since 1992, when the U.K. slashed borrowing costs following its exit from the exchange-rate mechanism that was the precursor to the euro. A key rate of 2.5% would also be the lowest for the London-based Bank of England since 1952. The benchmark U.K. rate stood at 2% through World War II and has never been below that since the bank was founded in 1694 to finance King William III's war against France. With regard to the stockmarket, Europe's Stoxx 600 advanced 12% last week, the biggest gain since September 2001. The rally pared the measure's October decline to 13%, still the steepest monthly drop since Sept. 2002.

Iceland was the worst performing European market last month following the collapse of the nation's largest banks. The OMX Iceland ICEX 15 plunged a record 81%, the biggest drop among 89 benchmark indexes. Nevertheless, cheap valuation of the European markets will draw smart money soon. The Stoxx 600 was valued last week at 7.9 times its companies reported earnings, the cheapest level since January 2002, according to data compiled by Bloomberg. In parts of the world, the dividends that stocks pay as a percentage of their current prices is higher than the yield on government bonds. In Europe, for example, the estimated dividend yield on stocks for this year is 5.2%, while the ECB's key interest rate is 3.75%.



## Microscope

For the past ten years, the euro has taken on a reserve role in an international arena. Total foreign reserves have risen almost 360% from US\$1.8 trillion to US\$6.4 trillion. The euro's share of these reserves has risen steadily from 18% in 1999 to 26% in 2007. The dollar's share meanwhile fell from 71% to 64%, according to Bloomberg. The rapid expansion of eurozone population and economy is the main driver of the euro's growing reserve role; other factors include the liquid eurozone financial market, leading to more euro-denominated transactions. Besides, there is increased use of euros in invoicing international trade, especially in Europe. Dollar weakness also leads central banks to diversify their holdings to the euro. As a result, many countries pegging their currencies to the euro - a third of all countries with pegged currencies - are European countries outside the eurozone, along with neighbors in the Middle East and Africa. These countries are the fastest accumulators of euros, using the euro reserves as support for their own currencies. The remaining two-thirds use the dollar as their anchor currency, especially East Asian central banks.

### MARKET BRIEFING

#### YTD % (local curr)

<b>US DJ</b>	9,325 (-29.7%)
<b>Nasdaq</b>	1,720 (-35.1%)
<b>Euro Stoxx 50</b>	2,591 (-41.1%)
<b>HSI</b>	13,968 (-49.8%)
<b>Japan NK225</b>	8,576 (-44%)
<b>China Shanghai Composite</b>	1,728 (-67.1%)
<b>Singapore</b>	1,794 (-48.2%)
<b>India BSE30</b>	9,788 (-51.8%)
<b>Brazil BOVESPA</b>	37,256 (-41.7%)
<b>Aus All Ord</b>	3,982 (-38%)
<b>US-10yr Bond</b>	Yield 3.96%

As at 31/10/08

## Insight:

### “Financial Crisis History”

The current market turmoil is centered on disturbances in the world's credit markets, according to BBC News. Worries about the viability of bank lending have spread around the financial system. The central banks and governments have been forced to pump in billions of dollars to rescue the current crisis. But what happened in previous financial crises, and what are the lessons for today? There have been a diverse range of financial crises in the world, according to the International Monetary Fund. Among the key lessons of previous major financial crises are: (1) Globalization has increased the

frequency and spread of financial crises, but not necessarily their severity; (2) Early intervention by central banks is more effective in limiting their spread than later moves; (3) It is difficult to tell at the time whether a financial crisis will have broader economic consequences. But it is sure to say that it will for this time; and (4) Regulators often cannot keep up with the pace of financial innovation that may trigger a crisis. The Wall Street crash of 1929 was an event that sent the US and indeed the global economy into a tailspin, contributing to the Great Depression of the 1930s. Today's scene is similar to that of 1929. By the time the market had reached bottom in 1932, 90% had been wiped off the value of shares. It took 25 years before the Dow Jones industrial average recovered to its 1929 level.

## A-Z Financial Tools

**Expense Ratio** is the percentage of the assets that are spent to run a mutual fund. This includes expenses such as management and advisory fees, overhead costs and distributing/advertising fees. The expense ratio usually does not include brokerage costs for trading the portfolio. As a whole, the expense ratio is often termed an Operating Expense Ratio (OER).



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