


Soft Commodity: Supply-driven Boom!



The surge in oil, metals, agricultural and soft commodities prices pushed the spot S&P GSCI commodity index, a basket of raw materials, above 400 points last week, the highest level since mid-November. This index is also 32% higher than in late December. This time, the rally is widespread. In metals, copper is near a six-month high; in soft commodities, soybean prices have rallied 22% this year while sugar has hit a 234-year peak. As economic "green shoots" after the financial tsunami seemed to be a reality, supply adjustments during the past few quarters, and the fact that US dollar weakness and inflation concerns over the long term, consumers and investors are bidding up commodity prices. Soft commodity prices soared in 2007 and early 2008 largely because of strong growth in demand, particularly from developing countries and from the biofuel industry. When signs of the global financial crisis

emerged, money flowed out of these markets. Beside the concern over the widespread recession, trade of these products was constrained by increasing difficulty in obtaining letters of credit during the period of credit crunch last year. In addition, falling oil prices compounded the sector's problems by making the use of agriculture-based biofuels less price competitive. These negative developments coincided with record harvests, particularly of grains and some oilseeds, which boosted supply and exacerbated the downward trend in prices. While prices for commodities and oil have plummeted, however, soft commodity prices have been more resistant in the first place. Demand for cocoa and agriculture produce has been stable. In coming two years, smaller harvests and lower yields owing to less investment by cash-strapped

farmers in 2008, coupled with already low stocks, will combine to see prices move higher. The oilseed price will also benefit from lower investment in 2009. Moreover, there is a likelihood that extreme weather conditions will recur in various parts of the world this year, leading to poor harvests, which will push up prices of soft commodities. Among those that could rise sharply are wheat and corn. In spite of commodities' recent strength, prices are still low compared with their mid-2008 levels, when the S&P GSCI index hit an all-time high of almost 900 points. In addition, investors are betting that a quicker than expected recovery in global growth will support commodities demand, just when supplies could be lower because oil groups, miners and farmers have cut investment during the financial crisis last year. 

Microscope

Soft commodity is again in the world news with the food crisis in 2007-08. After the financial turmoil in 2008, governments from China to South Asia are rediscovering their farmers. In Beijing, as in New Delhi, one hears the same worries, like growing income disparities between towns and villages, and rising imports of soft commodities. For example, raw sugar jumped 30% this year, in the biggest rally since 2005. India, the largest consumer, will boost imports 33% to 4 million metric tons in the year through September 2010 as consumers buy more soft drinks and processed foods, according to Bloomberg. The International Sugar Organization (ISO) also said that the deficit would reach 7.8 million tons this year, greater than a February forecast of 4.3 million tons. While Brazil, the largest grower, forecasts a 20% bigger harvest this year, the sweetener output won't be enough to meet world demand. India produced less cane after the government raised the minimum price for competing crops such as wheat in a bid to encourage enough grain output. Farmers also were encouraged to switch as cash-strapped sugar mills delayed or withheld payments for supplies. 

MARKET BRIEFING

YTD % (local curr)


US DJ	8,574 (-2.3%)
Nasdaq	1,739 (10.3%)
Euro Stoxx 50	2,462 (0.4%)
HSI	17,389 (20.9%)
Japan NK225	9,432 (6.5%)
China Shanghai Composite	2,625 (44.2%)
Singapore	2,238 (27.1%)
India BSE30	11,876 (23.1%)
Brazil BOVESPA	51,395 (36.9%)
Aus All Ord	3,919 (7.1%)
US-10yr Bond	Yield 3.29%

As at 08/05/09


Insight: "Fiscal Deficit and Inflation"

While the global economy continued to show signs of deflation, the unprecedented policies adopted by many countries prompted inevitable fears imminent inflation again. However, excluding food and energy, consumer prices in the US are up 1.8% from a year ago. In fact, fiscal deficit does not necessarily lead to inflation. But it is probable for this time. Fiscal deficit usually indicates government's total expenditure surpasses the revenue generated. US fiscal deficit would be 13% of GDP in 2009 and nearly 10% in 2010. In case there is a strong economic recovery, the ratio of government debt to GDP would double to 80% in the next 10

years. In the past, if the fiscal deficit is not accompanied by an increase in the money supply, the fiscal stimulus will raise short-term interest rates, hindering the increase in demand and preventing a

sustained rise in inflation. But now the large fiscal deficits around the world are being accompanied by rapid increases in the money supply. In the US, the broad money supply, consisting largely of government-insured bank deposits, is already increasing at 15% p.a. The excess reserves of the banking system have ballooned from less than \$3bn a year ago to more than \$700bn now. The situation is further exacerbated by "quantitative easing", in which the Fed will buy long-dated government bonds. According to Keynesian theories, when an economy is running near its potential level of output, fiscal deficits can cause inflation. 

A-Z Financial Tools

Sweetener is a kind of investment additive to a security that makes it more appealing to investors. One popular sweetener is the addition of warrants, or options to buy stock to a bond in order to make the bond marketable with a lower interest cost. Many start-up companies or not highly rated issuers issue stock warrants or options so as to capture the required amount of capital with low cost. 



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