

Europe: Walking on Tightrope!




Microscope

Although the financial tsunami has damaged the economic infrastructure, it is in no doubt that the global economy becomes more balanced. Euro becomes more and more important as the US government should sell more debt to finance its budget, which in turn, increases the depreciation risk of the US dollar. Dollar-dumping by Russia is another sign of the world losing confidence in the US reserve currency. Although Russia increased its investments in the debt securities of the US Treasury from \$32.7 billion as of December 2007 to \$116.4 billion as of December 2008, the US dollar was not Russia's basic reserve currency anymore. According to the Vedomosti newspaper, the euro-based share of reserve assets of Russia's Central Bank increased to the level of 47.5% as of January 1, 2009 and exceeded the investments in dollar assets, which made up 41.5%. In fact, Russia became one of the largest creditors of the US administration last year, according to the US Department of the Treasury. It is certainly right time now to reallocate the reserve currencies around the world as the US dollar has long been assumed to be too strong to fail. 

European stockmarkets rallied for a third week as confidence in the economic outlook increased more than economists forecast in July, adding to signs the deepest recession in more than six decades may be bottoming out. An index of executive and consumer sentiment in the 16 nations that use the euro rose to 76, the highest since November, according to Bloomberg. The Stoxx 600 index added 2.4% to 224.91 last week, near the highest level since November, as all 19 industry groups increased except oil and gas companies. The benchmark index for European equities climbed 9.3% in July, bringing the rebound from a 12-year low on March 9 to 42%. The rally has pushed valuations in the index to about 33 times its companies' past earnings, the highest level since January 2004, according to Bloomberg. This compares with a valuation of 14.2 times projected profits. Nevertheless, improving global

economy can certainly support such demanding valuation. For example, gross domestic product in the US shrank at a better-than-forecast 1% annual pace after a 6.4% drop the prior three months. This indicated the worst US economic slump since the Great Depression abated in the second quarter as government spending programs started to kick in, although the deepest retrenchment by consumers since 1980 augured a muted recovery. On the corporate front, while companies' sales show the crisis is here, they have managed to cut costs and help income in a quick and preventive way. Earnings at more than half of Stoxx 600 companies that have reported results since July 8 beat predictions, according to Bloomberg data, with profits shrinking 33% on average. Net income exceeded estimates by an average of

22%, while sales were almost in line with projections, exceeding them by 0.9%. For the full year, analysts expect 7.1% profit growth, according to the data compiled by Bloomberg. For example, Bayer, the largest drugmaker in Germany, said second-quarter net income dropped 7.3% to 532 million euros (\$753 million). Eleven analysts surveyed by Bloomberg had expected the company to earn 393.1 million euros only. It seems the financial crisis is over, but it does not. It is because bad loans may be the next wave of crisis. Governments around the world are selling record amounts of debt to revive their economies and bolster banks that have been hit by more than \$1.5 trillion of writedowns and losses since the start of 2007, according to Bloomberg. But banks that have fared relatively well so far will also be affected by this. 

MARKET BRIEFING

YTD % (local curr)


US DJ	9,171 (4.5%)
Nasdaq	1,978 (25.5%)
Euro Stoxx 50	2,638 (7.6%)
HSI	20,573 (43.0%)
Japan NK225	10,356 (16.9%)
China Shanghai Composite	3,412 (87.4%)
Singapore	2,659 (51.0%)
India BSE30	15,670 (62.4%)
Brazil BOVESPA	54,765 (45.8%)
Aus All Ord	4,249 (16.1%)
US-10yr Bond	Yield 3.48%

As at 31/07/09


Insight:

"Interest Rate Cycle Analysis"

As a matter of fact, the interest rate cycle is closely related to the economic or trade cycle. Interest rates are the main factor which can influence economic activity. For example, since the financial tsunami in September 2009, retail activity and capital investment around the world has slowed down. Therefore, many have been calling for substantial interest rate cuts to stimulate domestic demand. The lower the interest rate, the lower will be the finance costs for a company and the opportunity cost of savings for a depositor. Since 1997, worldwide interest rates have been fairly steady, the interest rate cycle has been less volatile. However, since 2003,

the interest rate has been much more volatile due to the economy being subject to periods of boom and bust after the financial crisis as a result of technological bubble. As such, once we understand the interest rate cycle, the investment strategy can be easily derived. So, what we can invest during the interest rate cycle? Your best guide to timing would be the interest rate cycles. The yields on real property follow the long bond yields, which means that when interest rates fall, the capital values of funds rise, and vice-versa. Therefore, when interest rates are rising, it is not the right time to buy if you are a short-term investor or speculator. But if you invest for the long term, these trends smooth out over time. Any time is a good time to invest in property-related asset, when the market is at its bottom, for instance, which it was in 2003. 

A-Z Financial Tools

Embedded Option is an option that is part of the structure of a bond that gives either the bondholder or the issuer the right to take some action against the other party, as opposed to a bare option, which trades separately from any underlying security. For example, it is commonly used in the structure of convertible bond, which is composed of fixed income and call option. 



IBC Group

Comprehensive Financial Planning
Wealth Management Advisory
International Business Advisory
Call 2268 6308
Email: insider@ibccapital.com

Next Insight
"Fund Flow Analysis"