


Global Stocks: Perfect Storm?



US stocks tumbled the most in a year as waves of computerized trading exacerbated a selloff triggered by Europe's debt crisis, sparking a slide in Asian shares. The rout briefly erased more than \$1 trillion in U.S. market value as the Dow Jones Industrial Average fell almost 1,000 points, a 9.2% plunge that was the biggest intraday percentage loss since 1987 and largest point drop ever, before paring declines. Although there are loan measures by EU and IMF, the 110 billion-euro (\$140 billion) aid package to avoid a default by Greece has failed to prevent bond yields from rising, driving up borrowing costs for countries including Spain and Portugal. Greece's parliament approved austerity measures demanded by the European Union and IMF. In fact, sovereign debt contagion may spread across Europe, affecting the banking systems of Portugal, Spain and Italy, as well as Greece, Moody's Investors Service said in a

report. Stocks got pummeled amid concerns European leaders won't do enough to keep the most indebted nations from defaulting. The losses snowballed as computerized trades sent to electronic networks caused some stocks to briefly drop more than 90 percent of their value. Procter & Gamble Co., the world's biggest consumer products company, fell as much as 37% before recovering all but 2.3% of its decline, according to Bloomberg. The worst scenario is that the European debt crisis may spread across the globe because of investor concern that governments have borrowed too much to revive their economies. Now, the cost of insuring against losses on European bank bonds soared to a record, surpassing levels triggered by the collapse of Lehman Brothers Holdings Inc., as the sovereign debt crisis deepened. The Markit iTraxx

Financial Index of credit-default swaps on 25 banks and insurers soared as much as 40 basis points to 223, according to JPMorgan Chase & Co. The prices of swap on Greece, Portugal, Spain and Italy rose to or near all-time high levels. In case German Chancellor and other euro region governments don't solve this problem, if they don't work together, this could potentially mean the dissolution of the euro. The spillover effect cannot be underestimated as there is a danger the debt crisis could spread to municipal debt issued by US states that are struggling to balance their budgets. The US federal deficit is forecast to reach \$1.6 trillion this year, or 10.6% of the economy, making it the biggest by that measure since World War II. If the euro sinks individual US states may be the next target. 

Microscope

European policy makers are under mounting pressure from investors and foreign officials to broaden their response to the Greek fiscal crisis after global equity markets tumbled. The euro dropped to a 14-month low last week as investors fret that politicians aren't moving fast enough to stem the worst crisis since the currency's inception in 1999. The selloff worsened after European Central Bank President refused to signal whether he will take further action to contain Greek contagion, eg. implementing new policies to combat the crisis such as buying government bonds or offering banks access to more cash on weaker terms. He instead elevated his demand for governments to cut budget deficits and said Spain and Portugal are not Greece. It prompted the U.S. and Asia to urge broader steps to prevent a global sovereign-debt crisis from pitching the world back into a recession. With the euro region's overall deficit forecast at 6.6% of GDP in 2010 and 6.1% in 2011, the vow to bring budget shortfalls back below the euro's 3% limit echoes promises that have been regularly broken ever since governments in 1999 set a three-year deadline for achieving balanced budgets. 

MARKET BRIEFING

YTD % (local curr)


US DJ
10,380 (-0.5%)
Nasdaq
2,265 (-0.2%)
Euro Stoxx 50
2,500 (-15.7%)
HSI
19,920 (-8.9%)
Japan NK225
10,364 (-1.7%)
China Shanghai Composite
2,688 (-18.0%)
Singapore
2,821 (-2.6%)
India BSE30
16,769 (-4.0%)
Brazil BOVESPA
62,870 (-8.3%)
Aus All Ord
4,507 (-7.7%)
US-10yr Bond
Yield 3.43%

As at 07/05/10

Insight: "Commodity Price Analysis"


Commodity prices are normally determined by the trend of the US dollar. A rising dollar is noninflationary. As a result a rising dollar eventually produces lower commodity prices. Lower commodity prices, in turn, lead to lower interest rates and higher bond prices. Higher bond prices are bullish for stocks. A falling dollar has the exact opposite effect, however. It is bullish for commodities and bearish for bonds and equities. In addition, economic growth does have impact on commodity prices. Especially, China's GDP growth will slow down from 11.9% in Q1 to 9% in Q4. Lower productivity growth, adverse

demographics and lower returns to capital will reduce future potential GDP growth in China to around 9%. The peak is already evidenced in the recent data. For example, industrial production has turned

and the growth in power, coal, cement, steel and auto production has slowed down. The circulation of money and credit, a major driver of commodity demand, could slow the economy down further. So, which commodities are most exposed to a Chinese economic slowdown? China's grip on the commodity sector has clearly intensified over the past few years, when the economic growth remained robust. Today, China is a net importer of every major commodity. For instance, just two years back, China was still a large net exporter of coal. Base metals are likely to suffer from a cyclical turn-around in China. 

Financial "In & Out"

IN: The price of US Treasury Bond was well-supported by the "quality flight" and the strength of the US dollar amid the concern over the debt problem in Euroland.

OUT: Corporate bond may face short-term selling pressure as the risk appetite of investors around the globe has been cut amid the concern over the debt problem in Euroland. 



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