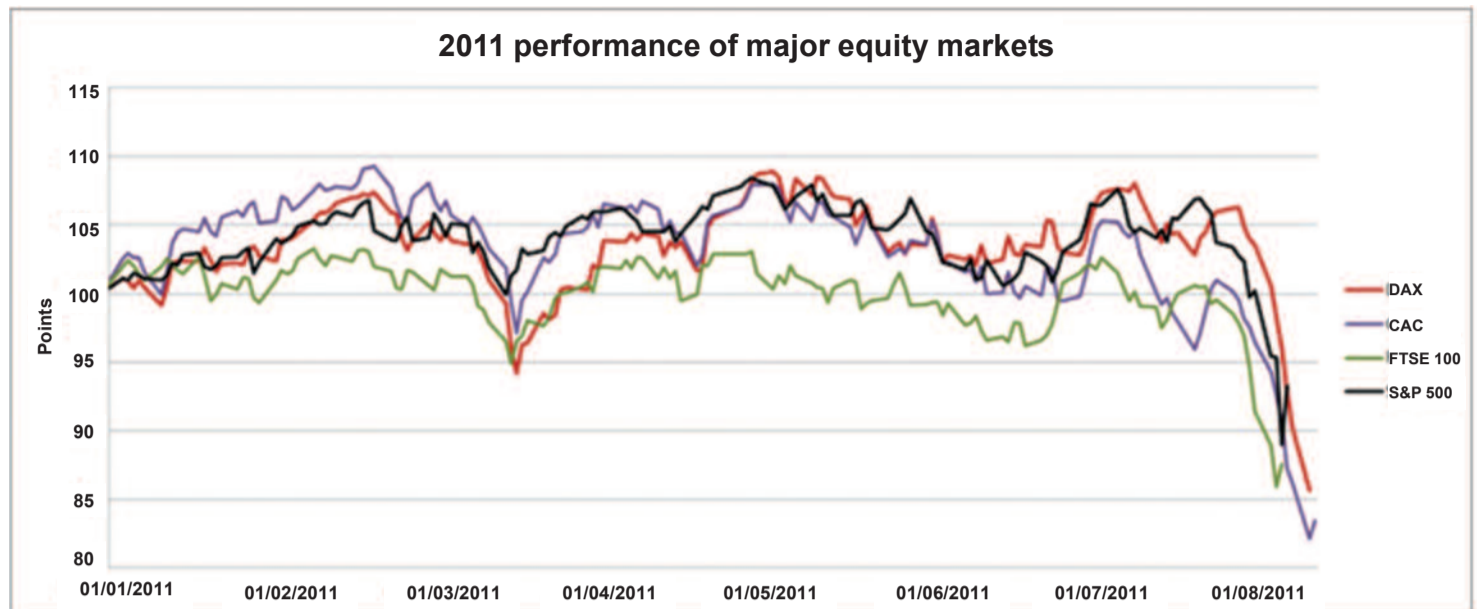


Stock Market Review



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Entering a bear market

A bear market is normally defined as a decline of 20 per cent in the value of the stock market. The recent sharp declines in all major international stock markets pushed some indices towards bear market territory while others have already entered an official bear market.

Last Monday, all the 500 companies constituting the S&P 500 index in the US declined on the same day. The last time this happened was in 1996. The S&P 500 has tumbled by 18 per cent since its recent high of 1,364.56 points on April 29. In Europe, the UK's FTSE 100 briefly entered bear market territory on Tuesday morning as this index declined by more than 20 per cent from its high of 6,103.73 points as recently as May 3. The German and French stock markets also breached the 20 per cent decline and are now in official bear market territory.

Germany's DAX 30 dropped by 24 per cent since its high on May 4 with France's CAC 40 nursing losses of 27 per cent since February 18. In Europe, the Italian stock market is among the worst performers having shed 34.3 per cent since February 17.

Some investors may be wondering what actually happened over the past few days causing such sharp falls across global markets.

The eurozone debt crisis had been among investors' major worries for a number of months with the EU and the IMF eventually having to bailout Greece, Ireland and Portugal. The necessity of a second bailout of Greece more recently raised fears that Italy and Spain (the third and fourth largest economies in the eurozone) could also be dragged into the debt cri-

sis, and this possibility sparked last week's turmoil. In fact, yields on 10-year bonds of both Italy and Spain surged above the six per cent level in recent days.

Coupled with the ongoing eurozone sovereign debt crisis, political haggling over the necessary raising of the debt ceiling in the US Congress stirred a further lack of confidence among investors. Although Congress approved a raising of the debt ceiling only hours before the deadline of August 2, weakening economic data coming out of the US was the last straw.

The world's largest economy expanded by just 0.4 per cent in Q1 2011 (a sharp downward revision from the previously reported 1.9 per cent gain) raising fears that the US economy will drop back into recession derailing global growth. On August 4, the Dow Jones index in the US recorded its biggest drop in a single session since late 2008 of 512.76 points or 4.3 per cent. This was followed by a steeper decline on August 8 (of a further 634.76 points or 5.55 per cent) when the market reacted to the news that the credit rating agency Standard & Poor's had lowered the 'AAA' rating of the US by one notch to 'AA+'.

Various international commentators have tried to explain the sudden sharp declines across global stock markets. The French bank BNP Paribas in a note to clients stated "the current situation could be seen as a fast, complete and unexpected loss of confidence that has been building over the past few weeks".

Back to the sovereign eurozone crisis. At an urgent meeting last Sunday evening, the European Central Bank announced that it will step into the bond markets to purchase Italian and Spanish gov-

ernment paper. While this helped reduce the yields to below the six per cent level on the sovereign bonds of both countries on Monday, this direct intervention by the ECB failed to curb the equity market falls.

Across Europe, all equity markets suffered further heavy losses at the start of the week. To make matters worse, following the US rating downgrade, market observers are now speculating that France and Britain are the most vulnerable 'AAA' European countries for a rating review. Weak economic growth and high levels of debt place both countries among the shakiest of the world's remaining triple-A rated borrowers.

The local market succumbed to all the bad news overseas by registering its worst daily performance since March 1999 with a decline of 4.63 per cent in the MSE Share Index on Tuesday. The local equity market is now also approaching a bear market having declined by 18.8 per cent since 27 January.

Among the worst performing sectors across global equity markets were banks and mining companies, although the sudden loss of confidence affected all sectors despite strong financial performances by many companies in recent weeks. Apple saw its share price retract by 12.7 per cent by Tuesday from its recent all-time high of US\$404.50 despite recently registering another record quarterly financial performance. As the share price recovered partially on Wednesday, Apple surpassed US oil giant ExxonMobil to become the most valuable company in the world.

Oil prices also tumbled on escalating fears about the health of the global economy with the price of crude oil retreating to US\$81 per barrel from a level of

US\$99 only a few weeks ago. On the other hand, a search for 'safe-haven' assets sent gold prices to record levels of over US\$1,750 per ounce with the Swiss franc and the Japanese yen also in strong demand by investors. The Swiss franc rose to record levels against the US dollar and the euro despite last week's efforts by the Swiss National Bank to stem the rise in the currency by cutting interest rates and flooding money markets with liquidity.

Following the widespread equity sell-off, some analysts are urging investors not to panic and to maintain their equity holdings. Furthermore, some commentators are also recommending long-term investors to hunt for outstanding buying opportunities citing attractive dividends and strong balance sheets as factors that will help produce a rebound in share prices when fear abates.

A columnist in the Sunday Times of London noted that the prospective dividend yield on the FTSE 100 index (showing the forecast dividend income for 2011 as a proportion of share prices) was circa 4.4 per cent as at last Friday compared to 10-year UK government gilts at 2.7 per cent. The columnist views this as a clear indication that blue-chip companies which can sustain their high dividends can be classified as bargains in the circumstances.

Although international share prices rebounded on Tuesday in response to the statement by the Federal Reserve pledging to keep interest rates close to zero for a further two years, equity markets are expected to remain volatile as had been the case in the previous global stock market crash in late 2008 and early 2009.

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