KMI EXCLUSIVE NEWSLETTER

19th March 2012

Dear Clients and Investors

In the last five weeks we have seen a range of events that start to point the way to the year's financial future. In this issue we try to explain the way we see markets going forward.

In this issue;

Valuations

We have noted a concern by our clients and we explain about structured products and their "Fire Sale" interim values.

Our New Corporate bond web site
See it now http://corporatebonds.kmiconsultants.com/

The Greek Debt - Is it Sorted?

Stock Markets - why the USA is outperforming China and the rest!

Structured notes and the interim valuations

It is often asked by our clients, "How can my valuation of a product with a conditional guarantee of capital show a large loss when the guarantee is still very much in place?"

These valuations, sometimes in products such as wrappers, are extremely confusing. However the answer is fairly simple; there is no secondary market, therefore the institution concerned, feeling they must insert a realistic valuation, do so by showing the "FIRE SALE" price; this is corrected when the note "calls" or "matures".

For example; a typical four year product, linked to say, three indices has a guarantee of 100% of capital unless one of the indices falls 50% at the end of the period (four years). It has six monthly calls where if the indices are all positive (above start levels) the Note will immediately repay capital plus interest usually, say, 6% (annual rate 12%). If not, the scheme rolls over to the next six monthly "call" where again, if the indices are positive the Note repays Capital plus 2 x 6% = 12%.

This continues on each six monthly period until four years is completed assuming the indices are below the start levels on each roll over date and at the term end then the full 100% of capital is returned to the investor providing an index has not dropped by 50%. Should the indices all be positive at the end of the four years then capital plus 8 x 6% is paid. i.e. 148% of the original investment.

So how can the product be valued less that at least the 100% of investment? Well, as mentioned, during the term, should a client wish to sell the Note back to the issuer, say ING bank for example, a very low price or "Fire Sale" value is quoted. Silly, but that's what is quoted by the institutions on valuations.

A recent example of a Note's values is as follows:

Fire sale value, £31,950.66; actual value (100% with capital guarantee) = £52,000.00, expected to call in September this year value = £62,400.00

Needless to say, clients should never sell notes until they either "call" or "mature". Please ask us if in any doubt.

Stock Markets - How near are they to their pre financial crises levels 2007/8?

Amazingly enough we still hear that "*China is the market of greatest potential". "Growth will come from China". "China is tomorrow's Great Economic power".*

And yet, the results below show almost the opposite. Why is it that the USA, considered to be the worst of the worst and mostly to blame for the financial crises, is the first market to recover its 2007 pre crises level? The USA considered the biggest debtor, (not that the UK is far behind; in fact statistics say far in front), has somehow managed to MAGIC the numbers yet again. Does this just mean that the rest of the world still follows the US Market? In this case I think not, we need to look elsewhere for a reason this time around!

Results

USA, Dow Jones this week regained its level of 2007 pre financial crises

Brazil; 9% down on its 2008 high level

UK FTSE is up to 90% of its 2007 level, down 10%

Taiwan; is 24% down on its high level in 2007

Hong Kong, Hang Seng index, 30% down on 2007 level

India; Ishares BSE index is 33% below its 2007 high level

Australia 200 Index is 37% off its 2007 high level

Euro 50 Stocks, still 44% off its 2007 level

Japan Nikkei down 45% on 2007

China (Shanghai index), still at 40% of 2077 level, DOWN 60%!

Looking at the above table, which is in performance order, a naive onlooker might think the order should be reversed. Surely, for example, Australia was not party to excess borrowing and would not be troubled by the financial crises. Why would Europe be so much worse off than the USA and cash rich China? Why has their market suffered so badly?

The answer I believe is threefold:

a) **Inflation which is only slowly becoming evident and has further to run in the western economies.**

b) **And the famous QE 1,2 & 3! Quantative easing, printing money; not billions but trillions, The USA and UK proportionately, followed by Europe, just cannot stop printing cash. This is having the feelgood effect in the USA and UK particularly, sending markets skywards.**

c) **Finally low interest rates in the USA and Europe; investors have to look elsewhere for almost any return on their investments.**

So should we be concerned? The answer is yes. Interest rates are being raised by the banks, particularly by stealth. QE is coming to an end, if slowly and that only leaves inflation to bolster future market rises. Yes we should be wary!

Greece

Greece was bailed out to the tune of 109bn Euros back in 2010. But by the middle of 2011, it became clear that this was never going to be enough for Greece to pay off its massive debts as its economy shrinks.

So Greece's benefactors - the International Monetary Fund and the other Eurozone governments - agreed a second bailout worth 130bn Euros. But one of the key conditions was that Greece would reach a deal with its existing private sector lenders to reduce its debt.

This would be done through a swap of old bonds with newly-issued bonds that would be worth a lot less and pay less interest. After negotiations between the Institute of International Finance (IIF), which represents most of Greece's private sector creditors, and the European Central Bank - which also owns a lot of Greek debts as a result of efforts to prop up Greece's banks and its bond market - a deal was finally reached in February.

Private holders will take a 53.5% nominal loss on their Greek debt - which works out to a real loss of about 74% after taking into account the loss of future interest payments, and the extra time being given to Greece to repay its reduced debts.

That means Greece wipes out what it owes on more than half of its 206bn-euro mountain of debt. The 107bn-euro losses - the "haircut" - being allocated to lenders, along with another huge package of public sector spending cuts, aim to reduce the Greek government's total indebtedness from 160% of GDP now to 120.5% by 2020.

So is it all ok now? **Probably not. With still nearly half the debt left and doubtful austerity policies at home, there's more to come here!**

Happy investing

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New Web site www.kmiconsultants.com

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