



## THE GRIZZLY RESTS!

Issue 10 Volume II

**REMINDER:** In September's report, I had mentioned that we were nearing the end of the brief rally from the July lows and had advised you to dump your stocks and equity based mutual funds. Our forecast was relatively correct as the market declined most of the past month. Six days ago the market tested its July lows and since then it has put together a fantastic "whopper" of a rally. The Dow has piled on over 1,000 points and the S&P 500 and the Nasdaq have also surged towards the moon. So, have we finally got the ever-elusive market bottom we were all anxiously waiting for. The birth of a new bull-market which will make investors and punters extremely wealthy? Ummmm.....With the S&P 500 selling at 33 times earnings and yielding a miserly 1.99%, I have to say we have our doubts!

**CURRENT MARKET SITUATION:** Taking a bigger perspective, US stock indices have declined for 6 consecutive months. As of last week the market was extremely oversold from any historical perspective. In fact, the market rubber-band was so stretched that it could have either snapped or pulled-back. A pull-back or rebound is what we got! As I write this on the 18<sup>th</sup> of October, we believe this rebound may last for a few days, however without the intensity we have seen over the past week.

Primary (genuine) bull-markets always begin with huge amounts of skepticism and fear on the part of investors. Towards the end of great bear-markets, investors are so frustrated, angry and beaten up that they don't even want to hear about stock investing. More importantly, primary bull-markets begin with stocks selling at "GREAT VALUES". How do we know when stocks are selling at such values – we know when common stocks are trading with Price/Earning (P/E) ratios of below 10. At great buying opportunities, common stocks normally offer a dividend in the region of 5-6%. At present, 500 of the biggest US stocks are trading with P/E ratios above 30 while offering less than 2% dividend! A small problem don't you think?

**DIVIDENDS:** The problem is that nowadays investors don't give a damn about dividend income – "Who cares about dividend income, just carry on investing brother, as stocks always go up over the long-term". You'll be surprised to know that over the past 100 years, the majority of returns from stocks have come from the compounding effect of dividend income. The annual income (dividend) "thrown off" by a company is more likely to be responsible for the bulk of your profits rather than an increase in the company's stock price itself! Coming to the logical question – How much dividend do

your stocks pay? Chances are zero or very little. When (historically) the bulk of stock market returns have come from regular dividend income, then how you are going to profit when your stock doesn't pay any dividend at all!

The euphoria and madness of the roaring nineties has changed the attitude and conceptions of millions of investors. Let's try and revisit what it means to be an investor or a stockholder. If you hold a company's stock, you effectively become an owner of the company's business. When that company makes a profit, common sense says that you should be entitled to a share in that company's profits. Companies distribute their profits amongst the shareholders in the form of dividends. This is probably the single-biggest reason why seasoned investors such as Warren Buffet and Li Ka Shing acquire or invest in a company by buying its shares. They part with their hard-earned capital in the hope that ultimately the company will start to produce profits and they will receive regular income in the form of dividends. As a shareholder, you are at the bottom of the pile. If the company or the business you invest in was to go bust, then you would be the last party to be paid. Therefore, as somebody who will suffer the most during bad times, it only makes sense to receive dividend in times when the company does register a profit.

Take a look at Microsoft for instance. During the late nineties, this company made billions of dollars in profits. Shockingly! Microsoft never paid an adequate dividend to its shareholders. If you are Microsoft's shareholder then you have watched your business and its CEO become somewhat relaxed about his financial position, while you are now suffering because it's stock price has fallen out of bed! Doesn't make any sense. Microsoft's shareholders are suffering because they couldn't care less about fair distribution of profits (dividends)! They became greedy and invested on the hope that the stock price would continue to rise infinitely. Imagine how they feel right now – pretty frustrated and angry!

The bottom-line is that you should only invest in profitable businesses which offer decent dividends in the region of 5-6% per annum.

Anyway, let's take a look at how a major private bank's clients have done so far this year. For the fear of being taken to court, we can't be specific. The following is a list of its most popular client positions and the performance of their "picks" so far this year:

AOL Time down 61%  
AT&T down 36.8%  
Cisco down 46.4%  
Citigroup down 34.7%  
GE down 37.3%  
Home Depot down 44.6%  
Intel down 56%  
IBM down 42.6%  
Lucent down 76.5%

Not a happy picture by any standards. Just goes to show what happens when you try and invest in a classic bear-market. The sad reality is that most clients haven't yet sold as they are being advised to "buy and hold for the long-term"!

During this historic bear-market, we will no doubt get rallies from deeply oversold conditions. Our advice is to use these rallies and get liquid in order to avoid further losses. Remember, everyone suffers in bear-markets, the winner is the one who suffers the least. There is no harm in cutting your losses and putting your money in assets which are conducive to the current market situation. No point in being stubborn as the bear will continue to oblige for months on end.

**GOLD:** We've had loads of queries about gold. So here is how we see it unfolding. Gold bugs will have to be patient. Gold's time is not here – yet. We are still in the very early stages of a bull-market in gold and usually this phase takes a long-time to play out. Our belief is that gold will slowly but surely grind to higher levels until the general public shows an interest. At that point, gold will enter the second phase of its bull-market and will begin to gain steam. Patience gold bugs, lots of patience.

So why do we think gold will go to the "moon"? As we've mentioned before, debt is now a huge concern in the US. It's debt is now 3.8 times its annual GDP. As deflation creeps in, this debt will become extremely difficult to service (during deflation the value of money goes up in real terms). When this happens, several more companies and individuals will no longer be able to service their debt and will eventually go bankrupt. This in turn, will cause banks and lending institutions to panic and easy credit will become a thing of the past. As this drama unfolds, investors the world over will rush towards gold. Remember, gold is the only form of value which is not someone else's debt. All currencies and every form of paper money is someone else's debt. Gold is outside the financial system and its supply cannot be increased by governments at will. China opens its gold exchange next month. The reason why the Chinese government is doing this is clearly because it wants to accumulate gold. It also wants its citizens to load up on gold, thereby making their currency more credible against the US dollar. The US dollar is no longer backed by gold and is an empty promise by its government to do "nothing". To add to the problem, the Fed is continuing to pump the system with more and more dollars in an effort to reflate the economy. What will happen to the dollar's real value as more and more dollars enter the system. I'll leave you to decide.

We urge you, beg you to take a position in gold. You don't have to like it, just go and buy it. You'll thank us for this piece of advice somewhere in the future.

**FORUM:** We have been running our investment forum for nearly 6 months now. It is extremely educational and has been very well received by the attendees. I don't want to blow our own trumpet, however we sincerely urge you to attend this FREE seminar. At the end of the day, you'll have some food for thought and you may or may not chose to act on our suggestions. The ultimate decision is yours and yes we don't have any hidden charges or agenda. Our only mission is to help you protect your assets from this crazy

bear-market. We've even given up our holiday (Saturday) in order to ensure that you'll have the time to attend. Kindly refer to the invitation for further details.

**SUBSCRIPTION DETAILS:** This report is a free service for Bridgewater clients. However, some of you have been receiving this newsletter on a trial basis for over 6 months. The concerned individuals have been sent a subscription form with this letter. Please complete and return it in order to become a paying member if you wish to continue to receive this monthly report. The nominal annual fee of HK\$ 300 will provide you with 12 monthly issues.

Bridgewater is an SFC registered investment adviser. The directors Stephen Gollop, Edward Cheung and myself have gained over 30 years experience in financial planning. **We are proud to announce that working in conjunction with the BPHR department of the Asian Development Bank, Bridgewater is employed as an external consultant to provide training and guidance to professional staff preparing for retirement. More recently, we have also introduced a mid-life financial planning course.**

Bridgewater will not be responsible for any investment decisions made based on this letter alone. We strongly advise that you arrange a meeting to understand the risk/reward profile before investing. You may contact us on [contact@bridge-water.com](mailto:contact@bridge-water.com) or please contact Ms. Pooja Balani on 2525 3639 if you would like to arrange a meeting. We hope this information proves useful to you and once again we wish to thank you for your continued support and positive feedback. Until next month, Goodbye and Good Luck!