



ISSUE 2 VOLUME III

HORSE or GOAT? OH NO! SAME BEAR...

IMPORTANT – *We have had a lot of queries from our subscribers regarding the services we offer. Our website is now up and running and we invite you to take a look if you are interested. It contains all you need to know about ourselves, our services and our track record. www.bridge-water.com*

Those who prefer to receive a soft copy of this report and save some trees, kindly send us an email along with your name. You may reach us on contact@bridge-water.com

KUNG HEI FAT CHOI – Let's start by wishing you all a very happy and prosperous Year of the Goat. After all the losses investors have suffered over the past 3 years, we sincerely hope (pray) that the coming year turns out be a good one. But will it???

FOOD FOR THOUGHT– This is how we see it... We're deep into the heart of this ongoing PRIMARY bear-market and all over the world investors have been stunned. If this year turns out to be a negative year then the stock markets would have dropped for 4 years in a row – Something which hasn't happened since the Great Depression of 1929.

Nearly all analysts and financial gurus are convinced that this will indeed be a prosperous year for the markets. They're anticipating a great rally once the war breaks out. Their thinking – well the markets "took off" when Daddy Bush attacked Iraq in 1991 so the same will happen now. But things are "slightly" different now -

The US did not face mountains of DEBT in 1991, however in 2003 the US is up to its eyeballs in DEBT! Total US debt is close to US\$ 37 trillion or 370% of its annual GDP!

In 1991, stocks were trading at 15 times earnings which in turn provided a platform for a multi-year bull-market. As of yesterday, the S&P 500 was trading at 29 times earnings!

Back in Daddy Bush's time, the US economy was vibrant and its industry was flourishing. In 2003, China has emerged as a world leader in manufacturing and due to its low costs of production, factories are closing down in the US and moving to China. Hardly a good sign for US business! Globalisation, dear subscribers, globalisation!!!

Back then, the unemployment rate was very low. In 2003, as a result of factories closing down in the US and moving to China, the US unemployment is sky-high and still rising.

Okay, okay...enough said about the pathetic fundamentals, now let's turn to the markets.

THE YEAR AHEAD – The markets staged a lukewarm comeback after its October lows and made a high earlier in January. Since then we've had slow and painful erosion in the stock prices. Day after day, one stock after another "takes it in the teeth" and makes fresh lows. In fact, January turned out to be a negative month for the market, with the NASDAQ, S&P and Dow all dropping between 2-5%. This is a bad omen for the market as history proves that if January is a down month then 80% of the times the markets end the year down. The bulls might argue that we're only dealing with history here and going forwards the markets can do anything.

In last month's issue I had confessed that we believed 2003 would turn out to be a nasty year for the markets. We did get some hate mail from some die-hard optimists but so far the market action has confirmed our views. Honestly, the structure of this market in weakening and I'll explain that in a minute.

Most investors are only concerned about the daily price movements of the major stock indices and they only care if the market goes up or down. However, beneath these daily movements lies invaluable data which provides us with a wealth of information about the health of the market. For example, no one cares to look at Volume, no one gives a damn about Advancing and Declining stocks, no one bothers to look at New Highs and New Lows and the list goes on...

Over the past month, Volume has been rising each time the market has a down day. This tells us that more shares are being traded on days when the market drops. This is a clear sign of institutional selling, in other words big money saying goodbye to the market!

Since the January high, the number of stocks which Advance (go up) daily are getting lower and lower while the number of stocks which Decline are rising and rising rapidly.

Every day, some stocks make New Highs for the year, while some stocks make New Lows for the Year. Over the past month, the New Highs figure is declining while the New Lows figure is rising. In other words, more and more stocks are breaking support to the downside and very few stocks are managing to break to the upside.

To put it in a nutshell, this market is doomed and we will see true capitulation and nasty bear market action over the months ahead. Somewhere between now and October-November the market will make a genuine oversold bottom which will give birth to a tradeable intermediate rally. So our advice (to those who have been following our advice) is to stay on the sidelines and wait for this trading opportunity which lies somewhere ahead. Remember, this tradeable bottom may not be the final bottom in this ongoing

PRIMARY bear-market. For now, take your losses and get liquid. Look into investing in other areas which will benefit from this coming fiasco – Gold and hedge funds anyone?

GOLD & DOLLAR – “Oh no! Gold is too high, its only up because of war, it has no use, it is only good for filling bad teeth!” yeah, yeah, yeah....and so the story goes.

Gold is in a PRIMARY bull-market and it is still in its accumulation or the first phase of a multi-year rise. During this PRIMARY bull-market, gold will rise while “shaking off” the weak players. The rally will be slow, painful and volatile. Remember, Rome wasn’t built in a day. So is it a good time to buy now? Old subscribers know that we don’t even try and predict the short-term weekly or monthly movements. It’s a useless exercise. However, over the long-term we believe gold is dirt cheap and these levels will not be seen again for a number of years. Where do we think gold is going? Back in 1980, gold topped out at \$850 an ounce. Taking into account inflation over the past 23 years, that is equal to \$1, 800 in today’s dollar terms. So yes, if the current bull-market is anything like the bull-market of the late 1970’s then gold “should” rise to around \$2000 an ounce. Nobody can predict for sure, and we certainly don’t know how long it will take but eventually gold may reach that target.

The US/HK dollar is in a PRIMARY bear-market and will continue to decline against major world currencies and real money (gold). We expect the US dollar to decline by another 10-15% against the Euro over the coming months. In an effort to ward off deflation, the Fed is printing money like there is no tomorrow. US money supply is increasing at a rate of 10% per annum! What happens when you keep increasing the supply or number of anything???. Surprise, surprise, its value drops. Its pure and simple economics at its best. So please don’t believe the baloney that the US dollar is dropping because of Iraq jitters or some other inconsequential happening. It is dropping because the US Fed and Treasury WANT a weaker dollar. Why? So that they can kick-start the local industry by making their products more competitive in the international market. More importantly, they want to make the dollar worth less in order to avoid a DEBT-MELTDOWN. Remember, with so much debt out there, the easiest way to service this debt is to make the debt worth less in real terms. In other words, devalue the dollar. Therefore, if you hold most of your assets in dollars you MUST take action now.

In today’s economic climate, major changes are underway. Big, smart and intelligent money is leaving financial assets (stocks) and is going into market-neutral (hedge funds) and tangible assets (gold and other precious metals). Why is this happening? Its due to the fact that big players understand this debt problem and are loading up on assets which are free from debt. Please do not listen to the endless stories which are being churned out by the financial media and DO NOT keep holding your stocks or mutual funds for the long-term. Make a note of the following and bury it deep in your mind –

IN PRIMARY BEAR-MARKETS VALUES DETERIORATE OVER TIME.

Primary bear-markets are about clearing the euphoria and excesses of previous bull-markets and stocks go from being ridiculously overvalued to extremely undervalued. Our

view is that before this current bear-market is over, stock prices will be knocked down to their knees. To put it simply – stocks will be trading around 10 times earnings.

A large number of subscribers are under the impression that they HAVE to utilise our services once they have made contact with us. I'd like to clarify that we don't charge a fee for an initial meeting and are willing to assist anybody seeking financial help. So if this bear-market has caught you off guard and you want to rectify the situation, there is no harm or cost involved in seeking our advice.

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 33 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 or please phone us in order to arrange a meeting. Until next month, Goodbye and Good Luck!