



Issue 1 Volume III

NEW BEGINNINGS???

IMPORTANT THINGS FIRST – On behalf of everybody at Bridgewater, I would like to wish you a Happy New Year. May the coming year be a prosperous one for all!

We've received a record-number of new subscriptions over the past two months and we sincerely thank everyone for their continued support and positive feedback. For those of you who read this report with interest but haven't had the time or inclination to dish out HK\$300 per annum, c'mon send us your cheques...you've paid your tax bills now!

2002 REVISITED – This may sound rather bizarre, however the year gone by was a profitable one for our clients. Normally, we don't like to pat ourselves on our own backs but c'mon give us some credit...can you think of any advisers, fund houses or private banks who have made money for their clients last year? Not many I suspect.

We don't consider ourselves to be financial gurus with magical powers. In this business there are no gurus – it all comes down to understanding the PRIMARY (main, important) direction of the market. Once you have correctly identified the PRIMARY trend of the market, then all you have to do is to use a bit of common sense and believe in your own convictions. Sounds easy? You bet it isn't...

Quite frankly, no analyst will be "right" all the time. Every analyst gets it "wrong" occasionally and when that happens all you can do is apologise to your clients and promise that you will continue to do your best in the future. Fortunately (for us), all our major forecasts for last year turned out to be spot on –

Gold "took off" in December and appreciated by almost 25% in 2002.
The glorious US dollar commenced its freefall and depreciated by 15% against the Euro.
The Dow had its third down year in a row and declined by almost 20%.
The pathetic NASDAQ dropped by over 30% last year.

Okay, okay....enough of this self-congratulatory jibberish, let's turn back to the markets.

THE PICTURE: In the last report, we had asked you to watch the 8,771 level in the Dow and had forecasted that if the Dow did climb above its November high (8,771), then the stage would be set for a rally which could sustain for several weeks. Well, last month

the Dow did manage to close above 8,771 and there you have it – a bear-market rally which has lasted for a few weeks!

Where do we go from here? Honestly...over the short-term, we don't know. But wait -- nobody else knows either. We can only make educated guesses about the exact future path of this ongoing "mother of all" bear-markets.

Last year was the third straight down year for this market (equity markets have declined in 2000, 2001 and 2002). Therefore, every analyst is convinced that the market probably can't and WON'T go down for a fourth straight year. Therefore, in early January investors (once again) have started to indulge in stocks as they seem convinced that stocks just can't go down for a fourth straight year! In our opinion, this hopeful sentiment is the real reason behind the recent strength in equity markets – but hey! what do we know. After all (over the past century) the stock market has gone down 4 years in a row on only one occasion. This tragic event took place between 1929-1932 and the bear-market ended with a vicious collapse in the Dow. So, do we think this can happen again? It most certainly can and the market is capable of doing absolutely anything!

QUESTION: Are we going to participate in this bear-market rally?

ANSWER: You bet we won't! Here are the reasons why-

US annual trade deficit is close to US\$ 500 billion.
47 out of 50 of the "United" States are currently facing huge deficits.
Price/Earning ratios are ridiculously high (S&P currently trades at 33 times earnings).
Bush & Co. are salivating/drooling at the mere thoughts of combat with Saddam.
The US treasury has asked the Congress to raise its debt-ceiling to US\$ 6.4 trillion!
M-3 (money supply) is increasing at a scary annualised rate.

The current situation is too risky for our liking. Therefore, we will keep our clients' money "off" the table and let the strong-hearted enjoy the show. We'll watch the fireworks from the sidelines and instead invest in areas where the PRIMARY trend is bullish. Gold anyone???

QUESTION: When will this bear-market end? Should we invest in the US market?

ANSWER: The preceding bull-market lasted for 20 years and it was one of the greatest speculative manias in stock market history. Bear-markets on the other hand work to cleanse the euphoria, corporate lies and excesses of the bull-market. The greater the speculation at the top of the bull-market, the larger the need for correction and cleansing. Therefore, we anticipate this bear-market to last for some time to come. In our opinion and once again its only our opinion, this bear-market will eventually die with stocks selling at incredibly cheap values. Great Values are represented by P/E ratios below 10.

We will invest in US stocks when there is extreme black pessimism amongst investors. You'd have to think that would be a good time to invest because then everyone else can

also become positive after we've invested. On the other hand if you start investing when everyone else around you is also positive, then there is not much room for improvement.

Amazingly, the current situation is just plain surreal. Everyone is optimistic and is hoping for the best possible outcome – an easy war with Iraq, rising corporate profits and happy days for all. Three years of horrible losses have not managed to change this bullish sentiment whilst circumstances have continued to deteriorate. We've had ugly corporate scandals, a war is looming upon us and even the Twin Towers have fallen. What will trigger a change in mass psychology, which event will cause investors to become outright bearish – a mile-wide meteor hitting our planet maybe?.

At typical bear-market bottoms, retail investors always feel gloomy, frustrated and angry towards stocks. This is definitely not the case now and I am sorry to say that this is not the time when you want to be investing in US stocks.

GOLD – This sector represents the ultimate flight to safety. Gold is real tangible money with intrinsic value. With the Fed's inflationary policy of "printing themselves" out of trouble, only a miracle can save the US/ Hong Kong dollar from a total disaster. As the FED continues to pump more and more money into the system, the increased money supply will continue to cause the value of money (dollars) to decline in "real terms". It is this decline in the real worth of the dollar which will continue to cause the price of gold to go up in dollar terms. For the umpteenth time, we recommend you to allocate part of your portfolios to this sector. Over 10, 000 investors receive this report and we've been recommending gold for over 2 years now – yet only a few have dared to act and take a position. Meanwhile, gold has turned out to be the best performing sector whilst most retail investors have watched the show from the sidelines. The reason – a long (20 year) bear-market in gold has made investors really suspicious and doubtful about the sustainability of any further price advances. Such behaviour is typical of true bear-market bottoms!

FORECASTS FOR THE COMING YEAR – 2003

US equity markets – Our guess is that 2003 will turn out to be the fourth straight down year - stay away from US equities. Utilise the current strength and get liquid.

US/ Hong Kong dollar – The coming year may prove to be a disastrous one for the dollar. During 2003, you'll probably find the US/Hong Kong dollar depreciating by another 10-15% against major currencies (Euro, Australian dollar and Swiss Franc).

Gold – We are in the early stages of a multi-year bull-market in gold. The coming year will prove to be an extremely good one for gold and other precious metals.

Emerging Markets – Capital is saying goodbye to developed markets and is flowing into underdeveloped areas which offer great growth potential. From a long-term perspective, countries which have cheap labour markets and highly developed work forces are going to perform reasonably well.

IMPORTANT NOTE – Our website is now up and running. It contains a wealth of information and will be regularly updated. For those who are interested, here is our web address – www.bridge-water.com

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 contact Ms. Pooja Balani on 2525 3639 if you would like to arrange a meeting. Until next month, Goodbye and Good Luck!