MARKET TRUTH *Written by Puru Saxena*

BRIDGEWATER

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DEBTS, DEFICITS & MONETARY INSANITY

UPCOMING FORUM - I am pleased to announce that our next FREE Investment Forum is scheduled for 15 November 2003. The session will cover a wide range of subjects such as Global Markets, Investment Opportunities, Estate Planning, Basics of Investment and Risk Management. Please refer to the enclosed invitation for further details. For the benefit of those who do not receive this report on a monthly basis, please go to our website to register and to find out more about the upcoming event.

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THE BIG PICTURE – Let's start with a round-up of the past few years. The bull market in US stocks lasted for 20 years and finally ended in early 2000 with a vicious collapse of the NASDAQ. Following the "tech bust", global stocks declined for 32 months before forming the bear-market low in October 2002. Since then global equities have rallied sharply causing the majority of analysts to declare that "The bull is back!"

Ever since the NASDAQ toppled, the Fed has been fighting the recession with all its might. Short-term interest rates have been pulled down and down while liquidity has been surging. The American public has repeatedly been brainwashed into believing that it is okay to keep spending and investing. After all, the "Great American Dream" must carry on! So far the public has responded by spending and spending some more. The widespread belief is that the Fed will manage to rescue the economy and there's no need to worry as better times lie ahead. Well, the problem is that while creating the biggest spending orgy this world has ever seen, the American public has taken on mountains of debt. With household debt-levels at all-time highs, clearly, our American friends have been spending money they don't even have!!!

The grim reality is that this debt has to be serviced and ultimately paid off. Now, due to stiff Asian competition and lower costs of production, millions of jobs are being "transferred" to this part of the world. Whether you like it or not, unemployment in the US is becoming a real menace and this may seriously hurt sentiment in the future. If the American public was to become worried about the job market, it would

have no choice but to slow down on its spending. This would have dire consequences on an economy where consumer spending accounts for 70% of all economic growth. Just a thought...

The reality is that Asia is able to produce goods and services at a fraction of the cost when compared to the West. Due to globalisation and increasing international trade, consumers now have a choice of buying goods and services from the cheapest global source. The American public has also recognized this fact and as a result their trade deficit has ballooned to a record-high. Some sources claim that the annual trade deficit will grow to a mind-numbing USD 550 billion by next year! So even though the American consumer continues to spend, the real beneficiary is going to be Asia. As Americans continue to feast on cheap imported products, they are in fact supporting and feeding Asian economies. Countries like China and India are currently witnessing record-high foreign capital inflows as both the manufacturing and service industries move to the two most populated nations with a huge supply of cheap, abundant labour.

Believe it or not, both India and China's economies are advancing at a breathtaking pace. As these economies continue to expand and become wealthier, more than 2 billion lives will be changed forever as standards of living improve in these nations. Over time, India and China will no doubt become the biggest economic powerhouses of the world. Long-term, we believe Asia will provide economic leadership and its prospects look extremely promising.

BACK TO THE MARKETS – Over the past 12 months, global equities led by the US have rallied and rallied strongly. Despite mountains of debt, despite record-high budget and trade deficits, despite ridiculously high valuations, stocks have continued to advance. So what has been the real inspiration behind this multi-month stock market rally? Just like a hot-air balloon rises when more and more air is pumped into it, stocks have continued to rise as Central Bankers around the world continue to pump more and more liquidity. A surging money supply combined with constant doses of bullish forecasts from government officials and analysts have been responsible for this bear-market rally.

I have said it before and I'll say it again - stocks have now factored in a perfect recovery. In simple terms, the stock market has already discounted the best possible outcome. If earnings were to disappoint and if we were to hear some bad economic news, then (in our opinion) stocks may decline faster than anyone can possibly imagine. But so far the advance has been impressive and the market has held firm. How much longer will stocks continue to advance? Honestly, we don't know, but wait - nobody else does either! All we know is that if 100 years of market history is any guide then last October's low was not the ultimate low for this bear-market. Liquidity

and sentiment may dictate the market in the short-term but values ultimately prevail and with the S&P selling at a P/E ratio of 30, this market isn't offering any values. On the contrary, this market is screaming murder as stocks continue to be awfully expensive. Whether you participate in this monetary insanity is your choice but remember you are not buying any values. You are simply buying stocks in the hope that some "greater fool" will offload your stocks from you at a higher price. At Bridgewater, we would rather "miss the train" than sit on huge losses. After all, the name of this game is RISK MANAGEMENT and it is against our philosophy to chase highly speculative, overvalued markets. Honestly, we are more interested in the values being offered by the gold and precious metals market.

PERSPECTIVE – There is a lot of noise about the new "bull-market" in stocks and the public is getting very excited. Let's take a minute and put things in perspective. Since the bear-market rally began in October 2002, US stocks have advanced by around 20-25% in nominal dollar terms. Over the same period, the US dollar itself has dropped by around 15% against major world currencies! Therefore, the real return has been close to 10%. Was a 10% return worth all the risk you have been taking by investing in US stocks? We'll leave this for you to decide, you be the judge.

CURRENCIES & GOLD – History has shown that (in the past) whenever a country's current account deficit surged to 5% of its GDP, that country's currency took a swan dive. Now, the US is running a current account deficit close to USD 500 billion and its annual GDP is close to USD 10 trillion. Therefore, at least on a historical basis, the USD is now a prime target for further deprecation against major world currencies. It is our belief that the USD will continue to decline over the coming months (years?) and it may drop by as much as 30% against currencies such as the Euro, New Zealand Dollar and Australian Dollar.

Gold is in the early stages of a multi-year bull-market and somewhere ahead this bull-market will become totally public and euphoric. At present however, the public is largely unaware of the developments in the precious metals market and this is a big plus for the yellow metal. Since the start of this bull-market 3 years ago, gold has advanced by over 50% and the public (as usual) has been caught unaware. Its interesting to note that gold has followed its 8-week cycle for nearly 2 years now - all its advances have lasted for roughly 8-weeks and these advances have been followed by periods of 8-week of weakness and correction. Gold formed its recent high towards the end of September and since then it has been correcting. If this cyclical trend was to continue, we can expect gold to bottom around mid-late November. This would present a great opportunity to either take new or add to existing positions. Nevertheless, in the face of a correcting gold price, gold funds have been acting well over the past month and have refused to give up much of their recent gains.

STRATEGY – Over the past 3 years, we've been holding the majority of our managed portfolios in cautious market neutral hedge funds and this has worked out very well for our clients. As independent investment advisers/portfolio managers, we continue to research quality hedge funds all over the globe. Our recommended hedge fund portfolio has produced solid returns with low volatility.

Over the past 2 years, we've been very bullish on gold and this has turned out to be our best performing strategy so far. We continue to allocate 15-20% of our managed portfolios to this sector and hope to at add to this exposure over the coming months.

Asian equities and economies look promising over the long-term and recently we've been taking positions in a Chinese equity fund which continues to perform extremely well. Our aim is to further increase our Asian exposure, however with the US market looking increasingly vulnerable, we'll wait for a major sell-off before taking any new positions.

For the past 2 years, we've been holding a fund which shorts the US stock market. Due to the recent rally, this fund has taken a beating however we are confident about our economic views and believe this position will also turn out to be a profitable one.

This report does not constitute a recommendation to buy any of the discussed investments. Bridgewater will not be responsible for any investment decision based purely on opinions expressed in this publication. We strongly advise that you arrange a non-obligatory meeting with our team of specialist advisers to fully understand each strategy 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!

Both Stephen Gollop and myself appear regularly on CNBC, Bloomberg TV and RTHK Radio as guests and comment on various markets and economies. Please phone us or visit our website in order to obtain information about our upcoming schedule.

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