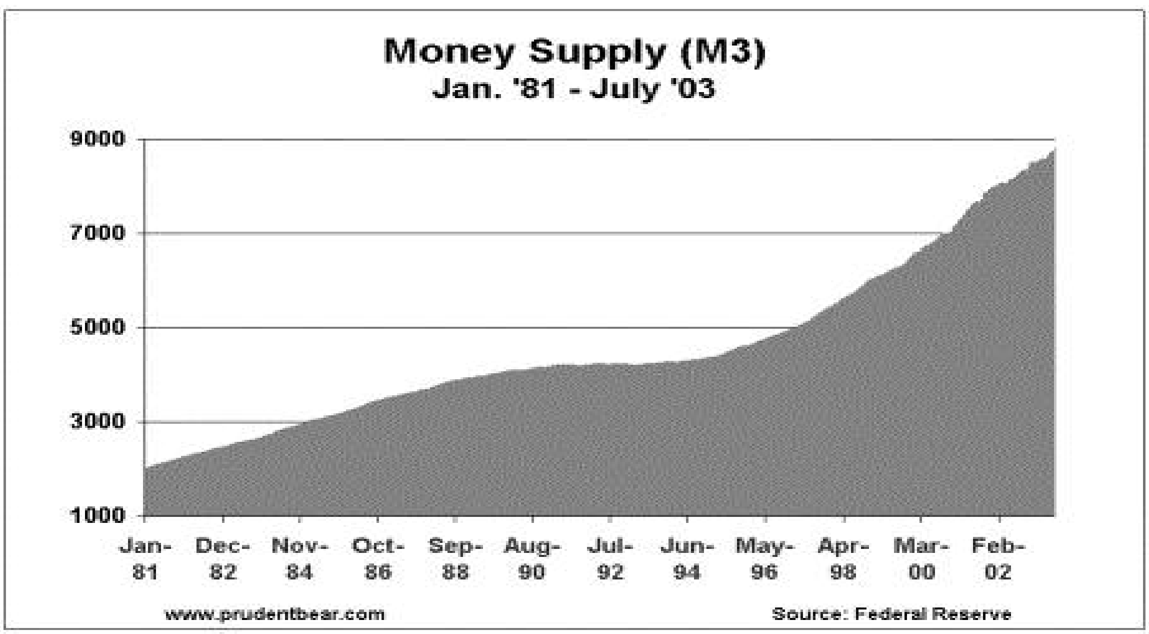
MARKET TRUTH Written by Puru Saxena

BRIDGEWATER

24 September 2003

ALAN IN WONDERLAND!

THE FANTASY – Our man (Greenspan) is pumping the system with more and more dollars – fantasy paper money which he produces “out of thin air”. Take this – M3 or broad based money supply is increasing at an annualised rate of 8.3%. Over the past 12 months, an additional trillion US dollars have been added to the system in the US alone! To put it mildly – Greenspan has been behaving like a kid in a candy store. Indulgence and some more indulgence….



Surging liquidity and artificially manipulated short-term interest rates have led stocks to rise against all odds. You can compare the current rally to a situation where you are sitting on a wooden couch and your living room slowly starts to flood with icy cold water. Surely, as more and more water flows into your room, your wooden couch starts to rise higher and higher. Eventually you find yourself against the ceiling as it becomes increasingly difficult to breathe. In the end you choke and drown in the same water which helped you float in the first place! This scenario is very similar to what’s been happening in the financial markets. On one hand you have the Fed with its money pump and on the other hand you have naive investors ready to invest this easily available money. But for how much longer can this fantasy game continue? This is the mystical question.

THE REALITY – Now, the general consensus is that the US economy is on the road to a "Jobless Recovery". Yes, can you believe it!!! **JOBLESS RECOVERY…**

Ever since this bear-market started 3 years ago, we've heard about a "V-Shaped Recovery", followed by a "U-Shaped Recovery", followed by a "L-Shaped Recovery" and now we have a "Jobless Recovery". What's next – "Dream Recovery"?

Anyways, let's get back to Planet Earth and review some cold hard facts –

- US Budget Deficit is set to exceed US$ 500 billion
- US Annual Trade Deficit is close to US$ 500 billion
- "Official" unemployment figures are close to 6.3% and this doesn't even include those who've given up looking for a job entirely. Unofficial and (probably realistic) estimates claim that the true unemployment stands in the region of 10%.
- What's this? Long-term interest rates are on their way up and the International Monetary Fund (IMF) is warning investors about a possible property crash in the making in countries such as the US, UK and Australia.
- Its true that the US economy has recently expanded but most of this growth has come from an increase in government defense spending. What? The govt. is spending money it doesn't have! Well, who cares, let's just carry on havin' a good time.
- US stocks are selling at a fat 33 times earnings while yielding a miniscule 1.7%.

CURRENT SITUATION - In last month's report, I'd mentioned that we believed gold was on the verge of an upside breakout whilst the US dollar was likely to weaken after its recent upward correction. Well, that's exactly what we got. After a long multi-month consolidation, gold did break-out to the upside and the US dollar started another downleg in its ongoing bear-market. Over the past month, gold rallied by over $20 per ounce and our gold fund holdings performed exceptionally well.

The US dollar has commenced its decline and is a good candidate for further depreciaton over the coming months. Let's put it this way – The dollar is very vulnerable and is at the mercy of its "foreign friends". But in order to make you understand what this means, I want to draw your attention to what's going on in this world.

The US imports a lot more than it exports to the whole world and makes these purchases in exchange for US dollars which it prints at will. Ah! The joys of owning the world's reserve currency… Now there is fierce competition between the nations which export to the US since the good ol' American consumer is the biggest consumer in the world. In order to keep their market share these nations are doing everything they possibly can and this includes artficially supporting the US dollar. So this is what's been happening – Once the exporting nations receive US dollars as payment from the US, they turn around and invest these dollars in US Treasuries and Bonds. So in fact, the US economy is living on borrowed money, money which is very kindly being lent to it by its "foreign friends".

As a result of this practice, foreigners now hold almost 46% of all US Treasuries. Close to US$ 2 billion of fresh capital inflows are required each day to prevent further declines in the dollar! What will happen when foreigners have had enough of dollars, what if their appetite for US Treasuries dries up? When this happens it will be like a small needle piercing a gigantic bubble – Not a pretty pop! If and when foreigners decide to trade in their dollars, Treasuries will crash and long-term interest rates will head skyward. This in turn will cause havoc on the property market which is being supported by mountains of debt. Not a pleasant thought dear readers, not a pleasant thought!

STRATEGY – Despite the recent stock market gains, this is still a bear-market and US stocks remain absurdly expensive. Long-term we are very positive about the emerging economies in Asia and have taken small positions in China.

Q) Why take only small positions if Asia looks promising long-term?

A) Although we're positive about the Asian economy, we still believe the US poses a "death threat" which could seriously hamper the global economic growth. You see, America is simply just too powerful and big for us to ignore. If its economy heads into trouble and consumer spending dries up, (no matter what you believe) all countries in the world will suffer to some extent. It is for this reason we refuse to take any major positions in Asian equity markets.

We continue to be very bullish about the prospects of gold. In a nutshell – you cannot afford not having a position in the yellow metal. If you haven't acted yet, now is the time to allocate 10-15% of your portfolios to gold. For those who acted on our advice and are now sitting on fat profits, utilise periodical corrections in this sector and consider adding to your positions. Despite the recent impressive gains, gold remains highly undervalued when you take into account the surging liquidity around the world.

Last but not the least, we sincerely advise you to take a look at cautious market-neutral hedge funds as an alternative form of investment. Normally, investors "freeze" as soon as someone mentions hedge funds as horror-stories of such funds going bust are much too frequent. Now, there are thousands of hedge fund strategies available and we've done extensive research in this field. After analysing 100's of funds, we have identified and selected 5 funds we are happy to recommend to investors. In these difficult times, our chosen funds have produced consistent returns with minimal volatility.

HOW WE CAN HELP – Bridgewater is an independent investment adviser regulated by the Securities & Futures Commission. We specialise in providing ethical investment advice and offer comprehensive financial planning services with access to global assets, satisfying both individual and corporate needs.

Please come forward and arrange a non-obligatory meeting if you feel you have been having a hard time wrestling with your current financial position. In order to obtain further information about services, please visit out website www.bridge-water.com

UPCOMING SEMINAR – For the benefit of those who are not on our database, I am pleased to announce that Bridgewater conducts regular educational seminars covering a wide range of topics such as Market Review, Investment Recommendations, Estate Planning, Retirement Planning and Risk Management. We have great pleasure in inviting you to our next session which is scheduled for 15 November 2003. Please visit our website to obtain details or to reserve a seat -- www.bridge-water.com

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.

This report does not constitute a recommendation to buy any of the discussed strategies. Bridgewater will not be responsible for any investment decision based purely on opinions expressed in this letter. We strongly advise that you arrange a meeting to understand the risks involved in investment. 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!

We are pleased to announce that both Stephen Gollop and myself appear regularly on CNBC and Bloomberg television as guests and comment on various topics of interest. Please visit our website in order to obtain further information about our schedule.

www.bridge-water.com