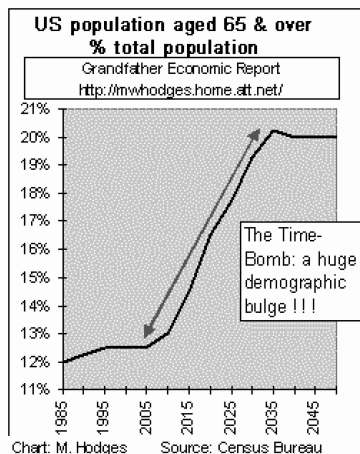


Sept 2006

Economic Review

WHO WILL PAY FOR THE PENSION HOLE?

While the current US\$ 500 billion under-funding of US corporate pension plans has received much media attention in the wake of the ongoing crisis in the US motor industry, it is the public pension and healthcare hole that could soon prove to be the final nail in the coffin of today's fiat monetary system. In almost every major developed country today the unfunded liability for public pensions amounts to 100 to 250 percent of gross domestic product (GDP) – an amount far greater in each country than its official public debt - while the burden of health benefits to tomorrow's elderly may be even larger. To give you an idea of how enormous these figures are, the US government's future unfunded liabilities were calculated by the renowned economists Smetters & Kent (2005) and estimated to have a present value of US\$ 66 trillion, prompting Laurence J. Kotlikoff, a professor of economics at Boston University, to comment in his report published by the Federal Reserve Bank of St. Louis last month that the United States "appears to be running the same type of ... policies that engendered hyperinflations in 20 countries over the past century."



Since the vast majority of Western governments have already spent all the pension savings made by the generation now retiring, and since all of these governments likewise are so highly indebted that there is no money for any pension shortfall in government coffers – the entire responsibility for the public household and pension of current retirees now rests with the current workers, which means that the system is very vulnerable to unfavorable demographic developments as we are seeing now. In the US, the 'baby-boomers' will be retiring over the next 25 years, while over in Europe we find France, Germany, Italy and Spain sporting the lowest birthrates ever recorded (1.7, 1.4, 1.2, 1.16 children per female respectively). The combination of falling birthrates and rising life expectancy results in a decline in the number of workers relative to benefit-eligible retirees, which exacerbates the public finances hole and leaves governments with no other funding option but to raise taxes. The question is only how much higher can taxes go without causing complete labor market collapse? Income taxes are already 49.3% in France, 40.9% in Germany, 42.5% in Italy and 37.8% in Spain, and these numbers still understate the burden placed on European workers as in each country total income tax revenue is not sufficient anymore to finance benefits, hence additional taxes are levied to make up the difference! The truth is that there is no more room left to raise taxes as more and more Europeans would simply stop working, or go into the underground economy, or just leave the country, as record numbers of Germans have been doing recently.

So who then will be picking up the bill for the public finance hole? History shows that where public liabilities become unserviceable, money will be printed in increasing quantities to make up for the shortfall. This basically means that anyone exposed to fiat currencies of relevant countries will be paying for these unfunded liabilities - via the hidden form of taxation called 'inflation'. Investing in a portfolio that includes tangible assets is therefore a must as a means of protecting one's capital against confiscation through inflation.

Getting it Right

WAKE UP TO WHAT THE MPF IS CAPABLE OF !

We all moan about the Mandatory Provident Fund ("MPF"), and certainly have a right to do so. It was forced upon us with little or no education on which scheme to choose or how to use it.

However, in an age where you are going to have to look after yourself, for many the MPF is falling far short of its potential. Contrary to popular belief the MPF is basically a well thought out pension scheme and it has been steadily improving thanks to a number of providers.

As the employee you probably had no choice over which provider's scheme you joined. For the employer little more choice was provided. It had to be implemented and with nobody but the tied sales forces out there it was impossible to separate the good from the bad and most simply chose their own bank or the first MPF company representative who came through the door.

Bridgewater has a full MPFA license as an INDEPENDENT adviser. Unlike the vast majority of those advising on the MPF, we are registered with the SFC and able to provide actual investment advice, as well as scheme advice. This means we can guide you to the best strategy and funds, rather than providing generic explanations and leaving you to try and tick the right boxes. Lack of such advice was the main reason why many members allocated 100% of their contributions to a guaranteed fund, which have returned an average of less than 2% per annum over the last 5 years.

Ask yourself a few questions:

1. Am I investing in the correct strategy for me?
2. Can I access good quality funds to build that strategy?
3. Am I required to carry out unnecessary administration work?
4. Am I in one of the best or one of the worst schemes?

Chances are you can't answer more than one of these questions!

We have carried out extensive research and can quickly advise if you are in a scheme which is amongst the best for you and your employer. Something rarely advertised is the fact that if you are in a scheme which is losing you money on returns, creating too much admin for your employer and lacking the innovations which the better schemes have been developing, you can switch the entire scheme without penalty.

With the employer's consent we can prepare an initial due diligence report on your scheme at no cost. Our corporate team can provide many complimentary services to the MPF ensuring that you have the opportunity to truly benefit from what these schemes are capable of. Remember, the MPF company representatives represent their own interests. Being independent means that we represent YOU.

Over the last 5 years millions of dollars and hundreds of hours have been lost unnecessarily, Isn't it about time to make sure you and your company are not contributing further to these figures?

Investment Focus

MPF INVESTMENT PERFORMANCE REVIEW – The MPF Schemes Authority recently published its Five-Year Investment Performance Review of the MPF System. As at 31 March 2006, Hong Kong MPF members had contributed a total of HK\$136.44 billion to the MPF system, which had grown to a total value of HK\$164.61 billion. For the MPF system as a whole, this represents an annualised return of 6.99% over the five year review period.

The performance of the various constituent funds of the MPF system varied widely, as summarised in the table below.

MPF Fund Type	Percentage of MPF Assets as at 31 March 2006	Average Annualised Return over 5 Years from 1 April 2001 to 31 March 2006
Mixed Assets Fund	48 %	6.90 %
Equity Fund	23 %	6.61 %
Capital Preservation Fund	14 %	3.06 %
Guaranteed Fund	13 %	1.26 %
Bond Fund	1 %	0.86 %
Money Market Fund	1 %	0.60 %

The MPFA's Five-Year Investment Performance Review is an excellent illustration and reinforcement of the fundamentals of financial planning that, although simple, are so very important to achieving your investment objectives.

Understand the Relationship between Risk and Return – No one likes to suffer a loss, but if you want to achieve high returns, you must be prepared to take some risk. Whilst the low volatility of Guaranteed and Money Market funds may give a

Source : Mandatory Provident Fund Schemes Authority 2006

nice sense of security now, investors are sacrificing potentially significant long-term gains which could make all the difference to achieving real security in retirement.

Use Diversification to Lower Risk – Not only did Mixed Asset funds outperform Equity funds, they did so with less volatility. This gets to the very heart of portfolio and asset allocation theory - by allocating your assets across different countries and different asset types, investors can reduce risk AND increase return. Diversification is the proverbial "free lunch".

Focus on Long Term Results – The MPF system was launched in the midst of one of the most savage equity bear markets in history, and annualised returns for the first two years were -2.49% and -11.21%. Fast forward three years, and the system has now produced a decent return, more than compensating for the initial losses. There will undoubtedly be more bear markets in the future, as there will surely be more bulls. Invest in the MPF with your long-term future in mind, and allocate your contributions accordingly.

Use Dollar Cost Averaging – Note that the MPF system as a whole returned 6.99% per annum, but the best performing fund type, which represents less than half of MPF assets, produced only 6.90% per annum. Whilst some of this difference was due to calculation methodology, the MPF system also produced a higher return through Dollar Cost Averaging. Most MPF funds fell in value during the first two years, and by regularly saving the same amount each month investors purchased more units as the fund price was falling. This reduced the average cost of each unit and increased the MPF system's total return relative to the underlying funds' returns over the last 5 years.

Get Serious! – It is amazing that so often we have clients that pore over every detail of their personal savings plans, comparing charges and features and actively managing their portfolios, but when asked about their MPF scheme they reply – "It was the one offered by my bank" and "I'm not sure of the current allocation". What started as a \$1,000 a month deduction from your pay packet is now building up, and it's time to get serious about the MPF.

Most employees have little choice with regards to their MPF scheme provider, hence we call on all employers in Hong Kong to do their staff a favour and contact Bridgewater for a truly independent review of your current MPF Scheme. We have thoroughly researched the market and can provide independent advice on which scheme is right for you. E-mail us at MPFsolutions@bridge-water.com for further information, or register for our Investment Forum below.

BRIDGEWATER FORUMS – OCTOBER 2006

Venue - Bridgewater Conference Centre - 1902 Cheung Kong Center, 2 Queen's Road Central

Saturday 21 October 2006, 2.00pm to 3.00pm; and
Tuesday 24 October 2006, 6.30pm to 7.30pm

MPF: WANT TO KNOW A SECRET? IT COULD BE YOUR BEST INVESTMENT!

Mr Stephen Gollop and Mr Mark Rawson of Bridgewater Limited will be sharing their insights as to the best MPF schemes, in terms of investment choice and performance, administration and customer service. You will learn how to select the MPF scheme and investment allocation that is right for you, and how to maximise your MPF opportunities to secure your retirement.

Please register your attendance by e-mailing forum@bridge-water.com, calling us on 2525 3639 or faxing a copy of this page, with your details below, to our office on 2525 3679. All information received by us is private and confidential.

Please register me for your October 2006 Investment Forum on (please tick):

Saturday 21 October 2006, 2.00pm to 3.00pm

Tuesday 24 October 2006, 6.30pm to 7.30pm

Name: _____ Phone: _____ E-Mail: _____

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