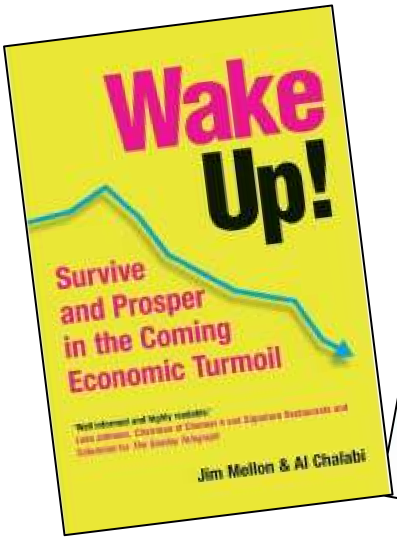
NEWSLETTER

Fourth Quarter 2010 Edition



This newsletter is brought to you by the authors of "Wake Up! Survive and Prosper in the Coming Economic Turmoil", and "The Top 10 Investments for the Next 10 Years" / "The Top 10 Investments to Beat the Crunch", all published by Capstone, part of John Wiley & Sons.

Subscription to this newsletter is free at www.wakeupnewsletter.com.

QE2 or Titanic?

Another quarter has flown by and what a rally we had in September and October in just about everything except the US dollar. Market jitters returned in November due to concerns over sovereign debt default in Ireland, Portugal and Spain. A lower risk appetite is providing support for the US dollar as the Euro's future as a currency becomes increasingly uncertain.

The rally has, to a large extent, been driven by the anticipation of the Fed's second round of Quantitative Easing (QE2). This was eventually announced in November to the tune of US$600 billion. With no signs of an economic recovery in the US, QE2 can only be described as an act of desperation by the Fed to prevent the US economy from sinking into deflation – something the Fed Chairman believes is to be avoided at all costs. Economists are split about QE2's effectiveness in warding off deflation but public sentiment everywhere is overwhelmingly against it.

Leaders of nations from Europe to Asia have heavily criticized the Fed for QE2 and its blatant attempt at debasing the US dollar. Unfortunately, we can expect to see further rounds of quantitative easing in the future unless US Congress can pass a bill to prevent the Fed from further trashing America's balance sheet.

For those of you who would like to have an explanation of quantitative easing presented in a light-hearted way, we recommend watching this humorous seven minute video that has been posted on YouTube recently: http://www.youtube.com/watch?v=PTUY16CkS-k

A Macro View

In mid-November, Al had the privilege of attending a presentation by Joseph Stiglitz in Hong Kong. For readers who may not have heard of him, Mr Stiglitz is an Economics Professor at Columbia University and former Chief Economist at the World Bank who won the Nobel Prize for Economics in 2001. In his speech, Professor Stiglitz gave a macro view of the current economic situation as well provide his economic outlook for the next five years or so.

In short, his stance on the economies of the US and Europe was incredibly bearish and he does not believe the US economy can make a sustainable recovery until it addresses the fundamental issue that created the economic mess in the first place: the banking system. He was very critical of both the Bush and Obama Administrations for not fixing it back when the financial crisis started in 2008.

"Instead," he added "they chose to change the accounting rules."

This has achieved very little other than rescue and reward the banks for the irresponsible practices that led to the crisis in the first place. To add to the gloom, he thought the US housing market would remain depressed for the foreseeable future with the number of foreclosures continuing to rise this year over last.

In my question to him, I asked how sustainable he thought it was to lend money at rates below inflation, where people who did not borrow were literally losing out financially to those who did. Savers who had acted responsibly all their lives and were living off interest payments from their savings or bonds no longer had an income stream they could live off due to interest rates falling to near zero levels, which in turn curbs consumer spending. He did not think that this was sustainable and couldn't think how it could end well although couldn't identify what would trigger its undoing.

Professor Stiglitz went on to say that the US had cleverly created a series of bubbles to keep the economy under the illusion of growth and prosperity for over a decade. First it was the dot-com bubble and bust, then the housing bubble and now bust. He speculated that the next bubble could be that of emerging markets.

Time for a Dollar Rally

In our last newsletter we suggested that readers buy some Singapore dollars (SGD), which has a managed float exchange rate that is based on the currencies of Singapore's trading partners. (Refer to last newsletter to see which currencies they are). Since then, the Singapore dollar has rallied by over 5% against the US dollar (USD), although it has come off a bit since it peaked in early November.

We're now of the opinion that the US dollar has been over-sold and that it is time for a moderate correction over the next few months as risk aversion returns due to an increasing consensus that global growth in 2011 will be far more sluggish than previous forecasts.

China: Course Correction Required

We have been writing about China's overheating economy for several quarters now and things have by no means improved. In fact, America's announcement of QE2 has made things worse because it has resulted in a fall in the US dollar, to which the Chinese Yuan is pegged to. China is an export driven economy and a falling currency against the Yen, Euro and other non-US dollar economies has made Chinese goods even more competitive, leading to increased demand, further fuelling domestic inflation. Food prices have risen by over 10% and talk of social discontent is on the rise in the local media.

China's domestic consumption is still insufficient to address the coming reduction in exports to the slowing, sluggish western economies. The two sensible options of raising interest rates and re-valuing the Yuan-US dollar peg are the tools Beijing should have used many months back. Instead, they increased interest rates nominally, although they are still negative in real terms and the peg has hardly budged.

Clearly this situation is becoming increasingly untenable and something will have to give, probably within the next few months. Either the US will slap tariffs on imported Chinese goods, or Beijing will revalue its peg to the US dollar. At the same time, interest rates will need to be increased to try and take some of the steam out of its domestic inflation.

China's export-driven growth model which has allowed the nation to average 10 per cent annual GDP growth for over a decade is coming to an end. Granted, China's GDP started from a low base but we are unlikely to see double digit GDP growth over the next 10 years. The next phase of growth model for China needs to be more balanced and sustainable, i.e. less export growth, more domestic consumption. Beijing is acutely aware of the challenges that lie ahead yet for the time being it has opted to sit on the side lines.

The New Gold Rush – Bioscience

Jim and Al are embarking on the most exciting thing they have ever done – a new book on the incredible developments in technology that are unseen to most people, but will deeply affect all of our lives in the near future.

All around us, superficial evidence of rapid technological change abounds – iPods, iPads, laptops, self-service at supermarkets, internet banking, electric cars to name just a few.

But what most of us are seeing is just the tip of the iceberg. The biggest change of all – the revolution in what might be loosely described as medicine – is under the radar but is about to have profound effects on the whole of humankind.

Ray Kurzweil's book "The Singularity is Near" proposes that by 2045 machine or artificial intelligence will overtake human intelligence. This event is the so-called "singularity" which he argues is the last invention mankind will ever need to make.

This massive advance in computing power, combined with several other factors, such as the sequencing of the human genome and its widespread application in: drug testing; the use of stem cell therapies to "regrow" vital organs; the use of nano-bots to deliver therapies in less invasive more effective ways; and the predictive power of computing to "personalise" medicine and to improve life expectancy will mean that before long (in 10 to 20 years) all known diseases will be curable, if not cured. The broad implications of this are profound – here are just a few:

1. Life expectancy throughout the world will rise dramatically, perhaps to 130 or 140 years at birth in the developed world within 20 years;

2. Population growth in almost all parts of the world will taper off, before populations start to decline (as people live longer, they have less children);

3. Advanced robotics will develop in tandem with bioscience to cater for the needs of rapidly ageing populations;

4. Big pharmaceutical firms will become vehicles to distribute drugs and to acquire biotech companies;

5. All industries will be affected, from insurance to casual dining to the media;

6. The bioscience industry will be an incredible place to make money, but the techniques will be akin to mining, i.e. backing lots of small investments hoping to strike one or two gold seams.

This is the new gold rush and Jim and Al are off with their picks and shovels to the centres of excellence in the field, including San Francisco, to learn, digest, inform and invest.

Our new book will be out in the middle of 2011.
Email us at authors@wakeupnewsletter.com if you want to be among the first to receive a copy.

We would like to take this opportunity to wish you a Merry Christmas and a prosperous new year. Have a good one wherever you are.