


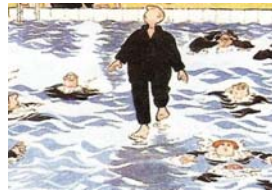
## Unobvious "Liquidity" Problem in China

AS the crowds get back to work after the Golden Week vacation, financial markets are back to normal with the flood of liquidity. The total market value of stock on the Shanghai and Shenzhen bourses has recorded 25.3 trillion yuan (US\$3.37 trillion) by the last trading day before the weeklong holiday, 44.8% of China's GDP in 2006, according to Bloomberg L.P. While the Shanghai stock market's index is edging toward new high, or seven times its level of just two years ago, some Chinese economists recently spoke about the threatening "three highs" - housing prices, stock prices, and the CPI (consumer price index, a measure of inflation). Although economists are still debating how much a bubble is being built up and when will it come to an end, the current general inflationary pressure is hard to deny. Why? This may be caused by a fundamental problem, like inefficient use of

resources. China is scouring the world for oil, natural gas and minerals to keep its economic machine humming. But trade deals cannot solve the tangible liquidity problem, ie, water. For three decades, water has been indispensable in sustaining the robust economic expansion that has made China a world power.

Now, China's galloping, often wasteful style of economic growth is pushing the country toward a water crisis. Water pollution is rampant nationwide, while water scarcity has worsened severely in north China - even as demand keeps rising everywhere. Water usage in China has quintupled since 1949, and leaders will increasingly face tough political choices as cities, industry and farming compete for a finite and unbalanced water supply. The obvious example is grain. China has


depended on imports to feed the country, but insisting on grain self-sufficiency. But growing so much grain consumes huge amounts of underground water. According to IHT, some scientists say farming in the rapidly urbanizing region should be restricted to protect endangered aquifers. Yet doing so could threaten the livelihoods of millions of farmers and cause a spike in international grain prices. China's disadvantage, compared with the US, is that it has a smaller water supply yet almost five times as many people. China has about 7% of the world's water resources and roughly 20% of its population. It also has a severe regional water imbalance, with about four-fifths of the water supply in the south. 



## Microscope

After three decades' of robust growth, China has accumulated \$1.3 trillion of foreign exchange reserves. This is about half of China's annual gross domestic product (GDP), which means every 2% points of revenue from the foreign exchange reserves equals 1% point of growth in GDP. Information about the reserve's investment portfolio is not available to the public, though research indicates a big proportion of its funds are in the global bond market, especially in US bonds.

Before 2004, the reserve's assets were primarily invested in US treasury and mortgage bonds. Putting the country's forex reserves into the bond market was fine when the reserves were small. The wisdom of this stance becomes questionable once the forex reserves exceed the amount needed for trade settlements.

Past experience proves that a stock-centered investment portfolio is much more rewarding than a bond-centered one. In the last century, the annual difference in returns between the two portfolios was between 5 and 8% in the US and around 3% in Europe and Japan. Accordingly, do you think the bubble in financial market will burst? 

### MARKET BRIEFING

#### YTD % (local curr)


<b>US DJ</b>
14,066 (+12.9%)
<b>Nasdaq</b>
2,780 (+15.1%)
<b>Euro Stoxx 50</b>
4,455 (+8.1%)
<b>HSI</b>
27,831 (+39.4%)
<b>Japan NK225</b>
17,065 (-0.9%)
<b>China Shanghai Composite</b>
5,552 (+107.5%)
<b>Singapore</b>
3,822 (+28%)
<b>India BSE30</b>
17,773 (+28.9%)
<b>Brazil BOVESPA</b>
62,318 (+40.1%)
<b>Aus All Ord</b>
6,617 (+17.2%)
<b>US-10yr Bond Yield 4.75%</b>
As at 5/10/07

## Insight: "Myth of Retirement Planning"


Myth 1: Retirees need 70% of their pre-retirement income to live comfortably in retirement. Myth 2: Retirees should only plan to support themselves when they retire....

In fact, life expectancy after retirement is increasing dramatically. Financial planning literature often recommends having enough post-retirement income to be able to replace 70% of pre-retirement income. The myth says that your lifestyle will reduce by 30% in retirement. Really? Let me ask you a very serious question. What three out of every ten things are you going to give up when you retire? Here is the truth: lifestyles do not go down

when you retire. In fact, lifestyles often increase due to more traveling and other postponed leisure activities. In addition, the two biggest villains for retirees are inflation and

healthcare costs, which are rising at rates in excess of inflation. Life expectancy for HK residents has hit an all-time high, according to a report from the Census and Statistics Department. In the 20-year period from 1986 to 2006, average life expectancy for female/male increased by 6.1/5.3 years. If you retire after 20 years (at 60), what you require is the additional reserve to maintain your lifestyle for extra years. The longer the horizon, the higher the risk your purchasing power will be eroded. That's why you should seriously plan for retirement. 

## A-Z Financial Tools

Correlation describes the degree of relationship between two things. It can be applied in portfolio formation. Asset classes with low correlation to each other are good choices for the diversified portfolio as each can perform independently of one another. In recent years, the performance of the metals and soft commodities markets has shown to be able to provide formidable returns. 



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