Information and Advice on World Stockmarkets from Securities Research Company's . . .

International Investor

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Inside International Investor

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World Stockmarket Forecasts

Stockmarket	One-Year Forecast	Fundamental Indicators	Technical Indicators	Monetary Indicators	Economic Indicators	Historical Performance (in US$) 3 mths	6 mths	12 mths	Share Index
Australia	52%	Neutral	Bullish	Bearish	Neutral	+1.9%	+1.2%	+15.9%	3,086.80
Austria	48%	Bullish	Bearish	Neutral	Neutral	-7.2%	-6.4%	-11.8%	1,164.05
Belgium	49%	Bearish	Neutral	Bearish	Bullish	-3.0%	+0.6%	-13.7%	3,262.50
Canada	49%	Bearish	Bullish	Neutral	Neutral	+12.2%	+11.7%	+27.8%	7,794.73
Denmark	51%	Bearish	Bullish	Bearish	Bullish	+4.7%	+14.6%	+9.4%	751.91
Finland	57%	Bearish	Bullish	Neutral	Bullish	+53.2%	+69.8%	+105.9%	12,151.69
France	45%	Bearish	Bullish	Bearish	Neutral	+9.3%	+20.6%	+25.4%	3,482.37
Germany	57%	Bearish	Bullish	Neutral	Bullish	+8.4%	+15.8%	+10.1%	6,119.17
Ireland	45%	Bearish	Neutral	Neutral	Neutral	-4.9%	-1.4%	-6.2%	5,019.21
Italy	50%	Bearish	Bullish	Bearish	Neutral	+1.9%	+1.4%	+2.4%	25,609.00
Japan	47%	Bearish	Bullish	Neutral	Neutral	+11.6%	+34.1%	+45.3%	18,368.14
Netherlands	48%	Bearish	Bullish	Neutral	Bearish	+1.4%	+6.3%	+10.1%	857.50
New Zealand	55%	Neutral	Bullish	Bearish	Bullish	+1.7%	+6.5%	+24.8%	2,385.88
Norway	61%	Bearish	Bullish	Neutral	Bullish	+2.9%	+11.7%	+30.0%	672.06
Spain	52%	Bearish	Bullish	Bullish	Bearish	+4.2%	+4.9%	+2.3%	982.76
Sweden	50%	Bearish	Bullish	Bearish	Bullish	+20.7%	+34.2%	+47.4%	5,018.15
Switzerland	45%	Bearish	Bullish	Bearish	Neutral	+0.2%	+1.5%	-4.9%	7,547.30
Un. Kingdom	60%	Bearish	Bullish	Bullish	Neutral	+6.5%	+5.4%	+16.2%	6,742.20
USA	46%	Bearish	Bullish	Neutral	Bearish	+5.6%	+7.9%	+21.8%	1,433.30
Argentina	61%	Bullish	Bullish	Bearish	Bullish	+7.3%	+0.3%	+17.7%	20,910.20
Brazil	68%	Bullish	Bullish	Neutral	Bullish	+31.2%	+18.7%	+21.1%	14,408.71
Czech Rep.	63%	Bullish	Bearish	Bullish	Neutral	-11.2%	-3.8%	+4.4%	1,483.00
Chile	77%	Bullish	Bullish	Bullish	Bullish	+1.0%	+0.7%	+17.5%	5,016.21
China	61%	Bearish	Bullish	Neutral	Bullish	+0.2%	+20.3%	+38.5%	719.60
Greece	51%	Bearish	Bullish	Bullish	Neutral	-3.5%	+30.3%	+93.5%	5,560.14
Hong Kong	61%	Bearish	Bullish	Bullish	Neutral	+20.1%	+27.3%	+58.5%	15,840.41
Hungary	55%	Bearish	Bullish	Neutral	Bearish	+1.1%	+17.8%	+21.0%	7,922.91
India	55%	Bearish	Bullish	Bullish	Neutral	+0.2%	+15.4%	+61.9%	4,714.14
Indonesia	58%	Bearish	Bullish	Bullish	Neutral	+14.0%	+12.6%	+62.4%	613.48
Israel	70%	Bullish	Bullish	Bullish	Neutral	+14.5%	+15.3%	+53.0%	395.54
Korea	42%	Bearish	Bullish	Neutral	Bearish	+10.0%	+22.9%	+119.0%	966.59
Malaysia	48%	Bearish	Bullish	Bullish	Bearish	-2.8%	-2.1%	+37.5%	724.63
Mexico	68%	Bearish	Bullish	Bullish	Neutral	+27.2%	+22.1%	+81.8%	6,470.41
Philippines	35%	Bearish	Bearish	Neutral	Neutral	-12.7%	-23.6%	+1.7%	1,936.90
Poland	33%	Bearish	Neutral	Bearish	Neutral	-10.7%	-5.1%	+11.1%	15,922.00
Portugal	47%	Neutral	Bullish	Bearish	Bearish	+7.4%	+6.9%	-8.6%	2,520.48
Russia	56%	Bearish	Bullish	Bullish	Bearish	+18.8%	+16.3%	+111.1%	1,111.08
Singapore	44%	Bearish	Bullish	Neutral	Bearish	+6.6%	+18.5%	+61.7%	2,227.81
Sth Africa	66%	Neutral	Bullish	Bullish	Neutral	+9.2%	+13.8%	+41.4%	7,714.80
Taiwan	56%	Bearish	Bullish	Neutral	Neutral	-0.9%	+7.1%	+13.3%	7,933.17
Thailand	34%	Bearish	Bearish	Neutral	Bearish	-4.7%	-17.3%	+13.2%	414.42
Turkey	72%	Bearish	Bullish	Neutral	Bullish	+49.5%	+40.7%	+114.6%	9,408.00
Venezuela	70%	Bullish	Bearish	Bullish	Bullish	+14.6%	-10.1%	+20.9%	5,287.58

One Year Forecasts predict the probability that a stock-market will rise over the next year. Investors should seek to invest in markets with forecasts of 60-100%, while avoiding markets with forecasts of 0-40%. Bullish = Favourable. Bearish = Unfavourable.

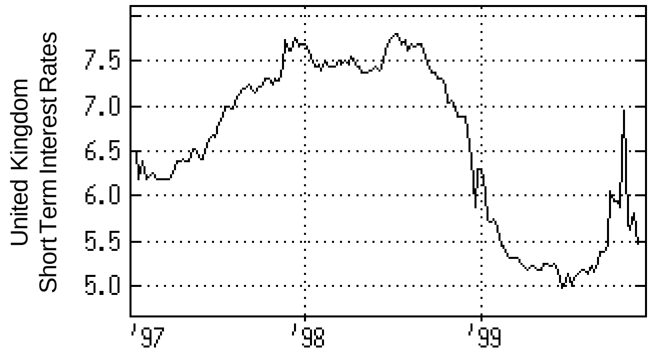
Stockmarket Outlook

Our stockmarket outlook for next year is discussed on Pages 4-5.

In the short term we continue to expect a strong rally in early January - as investors buy back into shares after Millennium fears prove excessive. Many investment "experts" and economists had made pessimistic forecasts over the impact of the computer Millennium problem - advising investors to reduce exposure to shares. That selling probably occurred in early 1999. Now, less than a month away from the big event, fears that computers will all fail and that the economy will grind to a halt are diminishing. We therefore believe that money is *already* flowing back into stockmarkets - resulting in the current rally. If that flow of funds increases sharply in early January, then stockmarkets will rise strongly as we have been predicting. <u>Remain fully invested in equities</u>!

Also of importance over the last month has been a sharp drop in United Kingdom interest rates - following the sharp rise in early October (when the maturity date of three month deposits passed into the New Millennium).

This drop in short term interest rates . . .



. . . has turned Monetary indicator Bullish (favourable), increasing our stockmarket Forecast back to 60% (from 46% in November and only 40% in October). While still relatively Neutral, that is one of the highest Forecasts among the major stockmarkets.

Recommended Funds
Geographic Portfolio Spread

Fund Name	Size	Leverage	Top 10	Portfolio invested in (%):-												
	(Mil)	(% debt)	Hldgs (%)	Cash	Germ	France	Switz.	Nethld	Italy	Spain	Sweden	Norway	Finland	Ireland	Greece	Denmark
TR European Growth Trust	£557	22	33.0	0.0	14.0	13.0	25.0	10.0	2.0	5.0	4.0	10.0	4.0	4.0	4.0	2.0
				Cash	HK	Australia	Malay	Japan	Taiwan	Korea	Sing.	Thail'd	Phil.	China		
AIB Govett Greater China	£7	Nil	39.3	0.0	56.0		2.0		7.0	20.0				15.0		
Fidelity Asian Values plc	£103	19	34.7	2.0	29.4		8.7		19.8		12.9	3.6			Other 23.6%	
Gartmore Pacific Growth Fund	£93	Nil	42.9	0.4	33.6	5.8	2.0		12.5	16.8	21.3	4.7	2.9		NZ 0.3%	
HSBC Asian Fund	£16	Nil	38.2	0.3	44.1	4.8	5.9		12.1		14.3	3.5	4.5		Other 10.5%	
HSBC Hong Kong Gth Fund	£20	Nil	57.4	3.5	96.5											
Martin Currie Pacific plc	£97	18	31.8	1.4	11.5	9.5		41.8	4.5	7.5	7.8	2.0	4.0	2.5	India 4.4%, Other 6.1%	
Schroder Asia Pacific plc	£119	Nil	34.9	2.6	36.4		5.2		13.4	16.7	17.8	3.5	2.4	0.3	Indonesia 1.7%	
Baring Korea	£65	Nil	41.3	4.8						95.2						
Old Mutual Thailand	£9	Nil	56.5	3.7								96.3				
				Cash	USA	UK	Europe	Japan								
Baillie Gifford Shin Nippon plc	£111	20	31.8	0.0				100.0								
Hill Samuel UK Smaller Co	£110	Nil	20.7	0.0		100.0										
I & S UK Smaller Coys IT plc	£60	12	34.0	3.5		96.5										
Invesco Japan Discovery Trust	£70	7	52.1	1.6				98.0								
Jupiter In'tl Green plc	£49	60	31.8	3.0	14.0	76.0	13.0	6.0	1.0							
				Cash		Asia		Latin Amer		Africa		Europe & Middle East				
Aberdeen Prolific Emerging	£11	Nil	22.5	2.5		42.7		25.7		9.0		20.1				
Templeton E/Markets plc	£725	Nil	23.3	4.4		37.3		34.6		14.4		9.3				

(South Africa 14.4%, Brazil 11.6%, Mexico 11.4%, Singapore 8.9%,Thailand 6.9%, HK 6.6%, Korea 6.3%)

Recommended International Investment Funds

<u>Asian Stockmarkets</u>

We had predicted 500-1000% gains from Asian stockmarkets over the 5-10 years *after* the 1997-98 crisis - and these countries now appear to be making the important transition from the *recovery* phase to the *growth* phase (see Pages 5-7).

The resulting asset re-allocation and forced corporate restructuring will likely keep Asian stockmarkets volatile - and result in a few mini-crisis situations - but offers further excellent growth over the medium to longer term. As previously, it is therefore necessary to remain diversified over many countries and several funds investing in this region - focusing on where these stockmarkets are going over the next year or five, not where share prices may be next month! The huge potential gains in this growth phase continue to justify slightly leveraging our portfolio to maximise profits - although again, long dated warrants (with many years to expiry) will see investors through the short term volatility while magnifying the long term growth potential.

It will also become important to focus on the *smaller* company sector as many of the biggest winners will be small companies that have not yet been formed and floated on Asian stockmarkets! Smaller Asian company shares have suffered during the crisis but, like smaller Japanese shares during 1999, could perform very strongly at some stage over the next couple of years.

Over the next several months we shall be realising some profits on our **Martin Currie Pacific** warrants (ahead of their June 2000 expiry date) and will probably look to re-invest that money in a new Asian fund. In the short term, the Martin Currie Pacific warrants offer a five-times leverage (i.e. the percentage rise or fall in the warrant price will be *five times* that of the shares), so should perform extremely well over the next two months if stockmarkets rise strongly in January as we expect.

As always, timing the best time to buy or sell is impossible, so investors should focus on the long term investment strategy (i.e. to be invested in Asia to profit from this “once in a lifetime” opportunity) and spread buying or selling over several months to average out the price of the transaction.

Fund News and Developments

Fidelity Asian Values plc has borrowed US$32 million at a fixed interest rate of 7.03%, repayable in September 2001. This leverages its portfolio, which is now funded 81% by Shareholders Equity and 19% by debt.

Invesco Japan Discovery Trusts plc has increased its capital by 2.4% through a placement of 683,000 shares at £2.18 - a 1.9% premium to net asset value on the date of this issue.

Fund Distributions

Now that we have all of our UK unit trust investments held in a broker's nominee account we are not immediately aware of all of the very small income distributions paid. Our half yearly statement reveals that **HSBC Hong Kong** distributed 4.18836 pence per unit in April, **Gartmore Pacific Growth** distributed 1.55558 pence in July, **AIB Govett Greater China** distributed 1.4589 pence in August and **Aberdeen Emerging Markets** distributed 0.20 pence in August. All of these gross distributions were less a 10% UK tax credit.

Current Advice	Investment Fund	EPIC Code	Initial Recommendation --- Date ---	Initial Recommendation Offer Price Foreign	Initial Recommendation Offer Price NZ Cents	Prem/ Disc to Net Assets	Recent Price Bid-Offer or Last Sale	Recent Price NZ Cents	Gain or Loss %
	Europe								
HOLD	TR European Growth Trust plc	TRG	11/02/97	157.5p	374.7	+1%	283.0p	894.2	+139
	Asia								
BUY	AIB Govett Greater China Fund	*	13/08/96	212.9p	480.4		237.51-254.03p	776.5	+62
BUY	Fidelity Asian Values WARRANTS	FASW	10/03/98	17.5p	49.7		35.25p	111.4	+124
HOLD	Gartmore Pacific Growth Fund	*	29/10/85	41.4p	105.4		211.70-226.42p	692.1	+557
BUY	HSBC Asian Fund	*	10/11/98	34.4p	106.3		55.36-59.08p	180.8	+70
BUY	HSBC Hong Kong Growth Fund	*	07/04/98	159.4p	481.6		207.40-221.30p	677.3	+41
HOLD	Martin Currie Pacific WARRANTS	MCPW	10/02/98	21.0p	59.3		33.75p	106.6	+80
BUY	Schroder Asia Pacific WARRANTS	SDPW	13/07/99	25.5p	75.8		28.5p	90.1	+19
	Japan								
HOLD	Baillie Gifford Shin Nippon plc	BGS	11/01/94	156.0p	440.3	-12%	253.25p	800.2	+82
BUY	Invesco Japan Discovery Trust	IJD	13/07/99	95.5p	284.0	-5%	191.0p	603.5	+113
	Korea								
BUY	Baring Korea Trust	*	12/04/94	81.1p	209.4		82.87-89.17p	271.8	+30
	Thailand								
BUY	Old Mutual Thailand Trust	*	08/12/98	49.0p	155.9		58.00-63.62p	192.1	+23
	International								
HOLD	Aberdeen Prolific Emerging Markets	*	13/08/91	39.0p	116.1		61.08-64.63p	198.6	+71
HOLD	Jupiter International Green IT plc	JUP	08/10/96	36.0p	80.7	-13%	54.5p	172.2	+113
BUY	Templeton E/Markets WARRANTS	TEMA	13/07/99	40.3p	119.7		36.75p	116.1	-3
	United Kingdom								
HOLD	Hill Samuel UK Emerging Coys	*	13/04/93	56.2p	159.1		160.86-168.44p	520.2	+227
HOLD	I & S UK Smaller Coys IT plc	ISU	11/02/97	160.0p	380.6	-25%	204.0p	644.6	+69

* United Kingdom based Unit Trust

Other Shares and Warrants

Alternative investments in the UK listed investment trust shares and warrants recommended above include **Fidelity Asian Values** shares at 94½ pence (-10%, i.e. a 10% discount to net assets), **Martin Currie Pacific** shares at 155½ pence (-14%), **Schroder Asia Pacific** shares at 87¾ pence (-10%), **Templeton Emerging Markets** shares at 130¾ pence (-17%), **Baillie Gifford Shin Nippon** warrants at 114¾ pence, **I & S UK Smaller Companies** warrants at 117 pence and **TR European Growth** warrants at 120½ pence.

Stockmarket Outlook for 2000 and Strategic Investment Review

Annual Forecast - 2000

In December of each year "International Investor" will publish its *Annual Forecast* for the coming year - keeping ahead of most publications that wait until January. A *Strategic Investment Review* will also look at where we should be investing and any necessary changes to our *Recommended Portfolio*.

United States, United Kingdom and European stockmarkets are still Expensive

The major stockmarkets (e.g. the United States, United Kingdom, European stockmarkets) continue to trade at historically high valuation levels (i.e. high Price/Earnings and low Dividend Yields).

These stockmarkets show many signs of a "financial bubble" but such a situation can become self-sustaining - at least for a number of years. A buoyant stockmarket boosts consumer spending, lowers the cost of capital and makes it easy for new companies to raise capital for growth. Usually economies become "over-heated" with inflation pressures and interest rate rises bursting the financial bubble. That is not the case at the moment with major economies growing well but not *too fast* - but world economic growth *could* pick up in 2000 or 2001 which may end the current financial asset boom.

Nevertheless, while the current situation may continue for a while, buying into stockmarkets at high valuations is unlikely to lead to high returns in the future. There is better *value* - and higher potential returns elsewhere.

South East Asia Favourable . . .

South East Asian stockmarkets continue to remain attractive for the 5-10 years of recovery and growth that we have predicted will follow the 1997-98 crisis.

As we predicted a year ago, economic activity started to recover from about the first quarter of 1999 - with most of the economies now showing strong economic growth and large trade surpluses, boosting domestic liquidity conditions which has significantly inflated share prices over the last year. In US dollar terms, the Hong Kong stockmarket is up +58.5% over the last twelve months, China is up +38.5%, Singapore +61.7% and Taiwan +13.3%, with Thailand up +13.2%, Malaysia +37.5%, Korea +119.0% and Indonesia +62.4%.

The stockmarket recoveries over the 12-18 months have been fuelled by domestic liquidity bubbles but the region is now moving towards the *growth* phase that we predicted would follow the crisis. This growth phase will result from the ongoing political and economic restructuring that is necessary in response to the 1997-98 crisis - which we discuss in greater detail later in this newsletter (see Page 5-7).

Therefore while earning significant gains from Asian investment funds (and warrants) over the last year, we intend to maintain a significant investment in this region over the next 3-8 years! Stockmarkets in this region, however, can be very volatile and the economic restructuring that we expect over the next several years will in many cases be forced upon the corporate sector. The most profitable Asian investments are also likely to be *companies that do not currently exist* but which will form and seek funding on the stockmarket to expand in growth areas in the Services sector.

Japan: Successfully Restructuring . . . at last!

Last year we rated Japan as "somewhat uncertain" - pointing out the problems with its banking sector but that economic conditions were favourable (i.e. the country was suffering a recession), the stockmarket was well below its previous peaks, monetary conditions were very favourable and that most investors/economists/fund managers were extremely pessimistic (which was favourable from a contrary opinion basis). In December 1998 the stockmarket was also showing "hints of a new uptrend". Our World Stockmarket Forecasts rated Japan at a favourable 82%.

As things turned out the Japanese stockmarket has appreciated +45.3% in value - but "smaller" Japanese company shares are up by a significantly greater amount. Our investment in **Baillie Gifford Shin Nippon plc** shares is up 355% (in NZ dollar terms) over the year, while **Invesco Japan Discovery Trust plc** has risen 113% since July (replacing **Gartmore Japan** unit trust which rose 45% from December last year through to July).

Why did Japan perform so strongly in 1999? The Japanese "bubble economy" collapsed in 1990, but the government stimulated economic activity allowing companies to avoid restructuring. The economy finally weakened in 1997, with a credit crunch in 1997/98 leading to many bankruptcies. As a result, restructuring could no longer be avoided in 1999. Several large financial institutions have merged, and industrial companies have also restructured. Accounting standards and corporate governance are improving. Financial institutions and stockmarket investors are demanding more efficiency, and corporate profitability is increasing (through cost cutting and down sizing) despite no growth in sales revenue.

Our current Forecast for Japan is Neutral - but our forecasting model is unable to measure the ongoing favourable impact of corporate restructuring. Therefore we remain happy to continue to hold an investment in Japanese shares.

Latin America

Our Forecasts for Latin American stockmarkets are moderately Bullish (favourable) and these markets offer the best fundamental *value*. Nevertheless we do remain cautious about this region which historically has not yielded the best investment returns. Latin American countries tend to have high national debt levels and low savings rates, making them dependent upon foreign capital and vulnerable to external "shocks" or a rise in US interest rates.

Investment Strategy for 2000

We shall continue to hold our international portfolio weighted towards Asian stockmarkets - believing that these stockmarkets offer excellent potential for growth. After a long delay, countries like Japan are now restructuring - which has produced significant investment gains in our portfolio over the last year. This process is just starting, so Japanese shares - particularly shares of *smaller* companies - remain very attractive and will remain in our portfolio.

Emerging stockmarkets have been *out of favour* for many years, and we believe these markets could perform very strongly in 2000 and 2001 - aided by steady world economic growth.

Finally - at this stage - we shall continue to hold a couple of United Kingdom funds and a fund focusing on smaller European countries. This provides some good diversification, with the United Kingdom (and some of the smaller European countries) being the most attractive of the major stockmarkets.

Strategic Investment Review

At our last *Strategic Investment Review* (*International Investor*, July 1999, Issue No. 43) we invested our small cash reserve (5-7½% of the portfolio) in additional Japanese and Emerging Markets funds, after which our portfolio was invested in the following areas:

Asian Regional	35-40%
Korea	5-7½%
Thailand	5-7½%
Japan	13-18%
Europe	5-7½%
United Kingdom	10-15%
International	5-7½%
Emerging Stockmarkets	8-11%
Cash	0%
Total	100%

and consisting of:

Trusts	85-90%
Warrants	10-15%
Cash	0%

Note: This assumes investments in the more volatile warrants at about 50-75% of the amount invested in other international trusts.

That spread of investments included Martin Currie Pacific warrants as a "Japan" fund after it built up large investments in that country (although we still list it in the portfolio under Asia). Strong gains by Martin Currie Pacific, Baillie Gifford Shin Nippon and Invesco Japan Discovery would have lifted the Japanese investments to about 20-30% of the portfolio (with reductions in other areas which grew strongly, but at a lower rate). This Japanese level should fall back to our 13-18% guideline early next year as we start to realise profits on the Martin Currie Pacific warrants ahead of their June 2000 exercise date.

Asian Economies and Stockmarkets: Moving from "Recovery" to "Growth" Phase

First Phase: Asian Crisis and Liquidity Led Recovery in Stockmarkets (mid-1997 to 1999)

Back in October 1997 we identified that *the end* of the Asian currency crisis would offer an important buying opportunity with stockmarkets likely to recovery 100-300% over a period of 3-5 years. Two months later, as the crisis worsened, we increased those recovery and growth predictions to a 500-1000% gain over 5-10 years.

In December 1997 we compared the Asian crisis to the Great Depression in the United States, the collapse of Germany and Japan after the Second World War and the United Kingdom's economic crisis of 1973-74. While the *cause* of each crisis is different, the impact upon the political system, the economy and the stockmarket have been similar. In each case, the political system and economy must change significantly to adapt to the crisis. Old, inefficient companies fail, freeing up capital and labour that can be better employed in newer, modern and efficient businesses. Also in each case, stockmarkets fell significantly during the crisis (e.g. 90% in the US, 90% in Germany, 70% in the UK) and then recovered and grew strongly, gaining 5-30 fold over the following 5-10 years!

The main reason for problems in Asia was a banking crisis, resulting from too much debt in the corporate sector. Banks were lending in local currency but had borrowed overseas in US dollars. Banking sector problems led to a currency crisis - with both exchange rates and stockmarkets falling very sharply.

The currency crisis, however, led directly to the "first stage" of the recovery that we have witnessed over the last 18 months. The crisis caused a sharp contraction in consumer spending. Faced with the prospects of job losses, Asian consumers increased their already very high level of savings, resulting in a sharp drop in imports. The lower exchange rate also boosted export businesses. The net result has been massive current account surpluses (which has removed doubts over Asia's ability to repay foreign loans)

(Continued on Page 6)

Asia: Moving from Recovery to Growth

(Continued from Page 5)

and a domestic liquidity bubble. With Asian economies operating at well below full capacity, there has been little need to invest in new plant and machinery, so this liquidity bubble has caused stock prices to increase significantly.

At the time of the crisis, many "experts" were doubtful about the prospects for Asia, but the current account surplus, liquidity bubble and stockmarket recovery was totally predictable and in line with our expectations - which we have backed up with "Buy" recommendations (and significant investments of our own money). The only difficult part was picking the *bottom* of the crisis. Even though we never expected to be able to accurately time the bottom, Asian investments built up during 1998 are already showing excellent gains!

Over the last two years most Asian countries have taken significant steps *towards* restructuring their political and economic systems. This is a long and virtually unending process of change with no "quick fixes".

Second Phase: Fundamental Economic Change, Strong Growth (2000 - 2010)

Asian economies are now poised to enter the second phase, where the current liquidity fuelled stockmarket *recovery* turns to real growth, driven by massive corporate restructuring and major economic change.

In this phase there will be several very major fundamental changes:

Firstly, underlying the major economic restructuring is the transition to a "rule of law" based business environment, replacing a system that in many countries was dependent upon the uncertain whims of politicians. An example of this transition is China's planned entry into the World Trade Organisation.

Secondly, *equity* will replace *debt* as the major source of new corporate financing. Asia's massive savings were historically deposited in banks, which lent to the corporate sector. Following the crisis, banks are under-capitalised and have non-performing loan problems, so cannot continue this function. Companies will be *forced* to make themselves attractive to investors to be able to obtain new equity capital.

Thirdly, *asset* based property and commodity companies will be replaced by companies seeking *profit* and *growth*, mainly in the service sector. Banks were interested in collateral for loans, so property companies were able to access (debt) capital before the crisis. Equity investors are interested in growth potential, so companies that can demonstrate the ability to earn profits and generate growth will be able to access (equity) capital in the future.

Fourthly, the change from *debt* to *equity* will result in the break up (or failure) of *conglomerates*.

Fifthly - and most importantly - the old, inefficient, large and often state owned companies will be replaced by new, smaller businesses. New business formation is very important, with new, smaller companies offering huge potential for economic growth in Asia - and the best returns for investors!

All of these areas warrant some further comment and analysis.

"Rule of Law" based Environment

A modern economy is only possible owing to fixed rules and laws that enforce property rights and contracts. The more successful Asian economies (e.g. Hong Kong) have adopted British legal rules, while the least successful (e.g. China) have only recently re-established individual property rights. The Chinese government's involvement in the economy was on a case by case basis with little or no enforceability of its obligations. That situation does not encourage the entry of new companies nor promote an efficient, competitive economy.

To achieve efficiency and growth, a government's involvement in business must follow open, clearly established rules - with an independent legal system that can hold the state accountable and enforce its contractual obligations.

China has made many moves towards improving its commercial laws, but its entry into the World Trade Organisation (WTO) is a significant move in that direction. The WTO is basically a set of rules with which its members promise to comply. China's entry into the WTO requires it to open up several of its protected industries (e.g. banking, telecommunications) which not only benefits exporters in these industries in the US, Europe and Japan, but will lead to better and more efficient infrastructure in China, which will support development in other industries.

Equity based Financing

Asians have always been great savers, but that money was deposited in banks which on-lent to businesses. This situation supported asset based (i.e. property) companies and conglomerates (where cross guarantees allowed companies to maximise their borrowing). Government policies (i.e. low interest rates) and relationships between the often family controlled conglomerates and the banks supported this situation which favoured large property and commodity businesses (with collateral) in preference to smaller companies and other industries.

Banks, however, can no longer continue the role of recycling personal savings to the corporate sector. The crisis has severely depleted their capital and they are left with many non-performing loans, so cannot expand their lending. Individuals are still accumulating savings, which are needed by businesses to fund future expansion. The solution is for companies to seek new *equity* capital directly from investors via the stockmarket - but to do this companies need to make themselves more attractive to investors.

Therefore Asian companies need to restructure, lower costs, improve profitability, adopt more stringent accounting standards and improve corporate governance to become attractive to investors and be able to attract new equity capital. Those that fail to adapt will lose markets to the companies that adapt and attract investors.

The Decline of Property and Manufacturing, and the rise of Service Industries

While Property, Infrastructure and Commodity businesses were best able to borrow prior to the crisis, these often high debt, family controlled conglomerates will be less successful at raising new equity capital on the stockmarket.

Equity investors are less interested in collateral and diversified businesses, but more interested in companies with a focused, profitable business with growth potential. Much of that future growth potential now lies in the *service* sector which is under-developed (owing to government restrictions).

The Fall of Conglomerates and the Rise of Smaller Companies

There are two aspects to this restructuring. Firstly, existing conglomerates must either restructure and break down into smaller, more focused companies (to become attractive to equity investors) or be unable to raise sufficient new capital and slowly decline. Family controlled conglomerates were a successful model under a debt funded economy, but fail under an equity funded model. To survive, the low growth parts of a conglomerate must sell assets to repay debt. Such low growth companies will also need to merge across borders throughout Asia to achieve economies of scale, reduce costs and improve profits. The most successful companies within a conglomerate will be able to seek new equity funding on the stockmarket but only by first improving accounting standards and corporate governance, cutting costs and raising profitability, and by focusing on specific areas where they have a comparative advantage and growth potential.

Secondly, the companies most likely to succeed in the newer Services businesses probably do not exist today. Business formation - new, smaller companies funded via the stockmarket - will therefore become an important part of Asia's necessary economic restructuring.

The Decline of State Owned Enterprises and the Growth in Private Enterprise

It is now almost universally recognised that most businesses are best financed and run by the private sector rather than the state. Even China long ago accepted that only a privately owned, market-based economy can deliver the economic growth necessary to deliver improved living standards. China still has 300,000 state owned enterprises, controlling 40% of the economy, but mostly dependent upon state funding and protection.

Just as other Asian countries have found an International Monetary Fund rescue package as a necessary reason for introducing unpopular but much needed economic reform, China is likely to be able to use its admission to the rule based World Trade Organisation as the reason to reduce support for many of these SOEs, reducing tariff protection, export subsidies and opening up industries to foreign competition. The decline of these businesses opens up huge opportunities for new private Chinese companies, which can be funded via the existing Chinese stock exchanges.

Summary and Recommendation

Asian stockmarkets offer huge growth potential over the next 3-8 years as the region goes through a period of major economic and corporate restructuring. The stockmarkets, however, will likely remain very volatile. Access to new finance and competitive pressures will force corporates to restructure. Corporate failure of old, established firms that resist change, or adapt too slowly, is also an important - and *positive* - part of this rejuvenation, although bankruptcies are usually reported as *negative* events!

Investors should therefore continue to invest in diversified investment funds - including those that invests in smaller companies. It is also important to continue to focus on the *long term* potential and growth, and not be distracted by setbacks, corporate failures, a liquidity crisis or short term stockmarket volatility.

Foreign Investment Fund Regulations

A subscriber wrote to point out that **Canada**, **Germany**, **Japan** and **Norway** are also exempt from NZ's Foreign Investment Fund regulations. Last month we had simplified our “Beginner's Guide” by listing only Australia, the United Kingdom and the United States as exempt and the securities of “all other countries” as subject to this unrealised capital gains tax.

While there may be some, we are not aware of *any* NZ investors who actually own any shares or units in Canadian, German, Japanese or Norwegian based companies or funds.

Gartmore Scotland

In October we recommended that investors reject the partial takeover for **Gartmore Scotland** capital shares. However, when we recently checked our FasTrade account we found that our 550 Gartmore Scotland shares were missing and that 1444 **Gartmore Split Capital Opportunities Trust** ordinary shares had appeared in their place! The broker had accepted the takeover offer on our behalf despite our specific instructions to them to reject the bid!

The broker has since corrected the situation, selling off the Gartmore Split Capital Opportunities shares and buying back our Gartmore Scotland capital shares (at, needless to say, no cost to us).

It would, however, pay for all investors holding Gartmore Scotland shares to check their accounts. Even if you gave the broker no instructions as to whether to accept or reject this partial takeover, the broker should have retained the original shares, accepted the takeover only if specificly instructed to accept the bid.

The Decline of Bond Funds will Force Corporate Restructuring in Korea

Korea - which has one of the most highly indebted corporate sectors dominated by conglomerates - will be at the forefront of the restructuring changes outlined in our previous article (Page 5-6).

When Korean conglomerates had exhausted bank borrowing they set up Bond Funds, taking in deposits from the public and investing in corporate bonds. The Bond Funds promised to repay deposits in full, so investors treated them as similar to bank deposits. The Bond Funds, however, have no external capital, so when corporate borrowers became insolvent the value of some of their investments diminished in value - leaving them unable to meet their promise to repay all investors in full. The Bond Funds then faced a "run" of redemptions as investors sought to take out their money.

To prevent this "run" of redemptions, the Korean government stepped in and partially guaranteed the funds' bond holdings. That has prevented massive redemptions, but left the government effectively guaranteeing the bond issues of insolvent conglomerates. Under an agreement with the International Monetary Fund, however, Bond Fund investments will be valued at market prices from mid-2000 - with investors' holdings in the Bond Fund fluctuating in value like normal unit trusts.

As existing bond investments mature the government guarantees will end and investors will bear all of the risks of new bonds purchased by the Bond Funds. Investors previously considered Bond Funds a capital stable, riskless investment similar to a bank deposit. Once they bear all of the risks and the capital value of their investment fluctuates in price it is expected that investors will start withdrawing money and that the Bond Fund investment schemes will be wound up over the next couple of years.

If the banking sector was strong, then investors could simply deposit the money in banks, who would lend it to corporates to repay their bonds. Following the 1996-97 crisis, the banks are under-capitalised and have non-performing loans, so cannot significantly expand their lending.

That will leave the corporate sector unable to roll over corporate bonds, as investors will be withdrawing their investments from Bond Funds. Investors will also be unable to re-invest the cash through the banking system. In most other Asian countries, companies will need to shift to *equities* to raise *new financing*, but in Korea there will be additional pressure to restructure owing to the collapse of the Bond Fund investment structure over the next year or two. Korean conglomerates will need to restructure to raise *equity* to repay bond issues at maturity!

Of course, all of the money that corporates need to repay bonds will be matched by the cash that investors receive from those maturing bonds and need to re-invest. But the requirements for raising new *equity* from investors in the stockmarket is different from the requirements of issuing a new interest bearing bond. Korean corporates need to restructure rapidly to become attractive to stockmarket investors. Those companies that restructure successfully will be rewarded by investors and be able to tap into the huge pool of investors capital currently invested in Bond Funds. Those companies that cannot adapt successfully enough or quickly enough will be unable to refinance maturing debt and be forced to sell assets, sell businesses or to fail.

Although the Korean government has led other Asian countries with restructuring over the last two years, Korean companies have resisted change. Bond Fund restructuring now leaves conglomerates with the choice of (1) restructure very quickly or (2) file for bankruptcy.

The Korean corporate sector owes about W550 trillion in debt (550 million million Won, or about US$480 *billion*) and equity (as measured by their stockmarket capitalisation) of W320 trillion. About W200 trillion (US$175 billion) of this corporate debt is held by Bond Funds. This is a *very large* amount of money, both in nominal terms and as a major source of corporate funding (about 23% of all corporate funding) that will need to be refinanced with new equity!

Summary

The situation in Korea is one of forced corporate restructuring - and will probably involve some crisis situations and major bankruptcies. This may lead to some wild fluctuation in share prices. However, this restructuring is favourable for the economy and stockmarket - as demonstrated by the rally on the Japanese stockmarket after the start of serious restructuring. Major company failures, the break up of family conglomerates and mergers are therefore signs that the restructuring process is progressing.

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