

Wealth Academy Annual Letter 2009

From the Desk of Adam Khoo

Dear Friends,

One year has gone by and a new one has just begun, so it is that time of the year when I write my customary report about the economy and the markets. What has happened and what to expect in the coming year.

The Worst Financial Crisis Since the Great Depression

If you are an investor who has had your confidence about investing shaken and have lost faith in making money in the stock markets, no one can blame you. Surveys show that many retail investors have thrown in the towel and are staying away from investing.

After all, what we are seeing something that has not happened for decades and is probably a once in a lifetime occurrence. We have seen:

- Unprecedented levels of volatility with the Dow swinging hundreds of points in both directions in a single day
- Markets collapsing worldwide at an unprecedented pace. US down 45%, Singapore down 61%, Shanghai down 70% in LESS THAN a YEAR. This percentage loss used to take 2-3 years to unfold. But high levels of de-leveraging by hedge funds and technology has accelerated the selling process.
- The largest and most reputable companies falling to near zero within months like Citigroup, Bear Sterns, Merrill Lynch, Lehman brothers, General Motors, Ford etc... and even entire countries like Iceland going to near bankruptcy
- Unprecedented volatility in the commodities markets with oil shooting to over US\$140 per barrel and then collapsing to less than US\$40
- Billion dollar scams and scandals –e.g. Bernie Madoff’s shock \$50 billion pyramid scheme
- Interest rates in the US cut to NEAR ZERO
- Even the greatest investors in the world like our dear Warren Buffett seeing his stock value drop by almost half and investments that went south (e.g. buying Goldman Sachs at a strike price of \$130, only to see it drop to \$60+)

All this shocking, bad news has sent intrinsic values and fundamental research out the window and sent stock prices into never imagined before territories. People do not know what to trust anymore in the market. All

this fear and uncertainty is driving the stock market lower and lower with increasing fears that the market will never recover and financial stocks may even go to ZERO.

The One Thing You Can Learn About History is that People Don't Learn from History

The one thing that we need to put in perspective is that this level of uncertainty and fear amidst collapsing prices has happened many times before. It is always at the point when the market plunges to a point when there is maximum pessimism and people believe that the market will never recover that the market sets the stage for the next strong rebound.

Those that stick to their keep their faith and confidence in the value of the companies they have chosen and stick to their investing plan and take on a long term viewpoint will be the ones who will profit.

However, most people never seem to learn from history and keep repeating the same mistake, selling and keeping away from the market when major crisis are where buying stocks are the safest and the most logical. By the time they overcome their fear and start buying again, the market would have run too high and ready for the next fall.

Here is a look at all the past stock market crashes and the time it took to recovery and how fast the recovery was:

Peak		Bottom		% Drop From Peak to Bottom	Recovery Date	Time from Bottom to Peak		Time from Peak to Peak	
Date	Close	Date	Close			Days	Years	Days	Years
5/29/1946	212.50	6/13/1949	161.60	-23.95%	4/12/1950	299	0.82	1,393	3.82
12/13/1961	734.91	6/26/1962	535.76	-27.10%	9/5/1963	429	1.18	622	1.70
2/9/1966	995.15	10/7/1966	744.32	-25.21%	11/10/1972	2,193	6.01	2,431	6.66
12/4/1968	985.21	5/26/1970	631.16	-35.94%	11/9/1972	883	2.42	1,415	3.88
1/11/1973	1,051.70	12/6/1974	577.60	-45.08%	11/3/1982	2,847	7.80	3,532	9.68
9/21/1976	1,014.79	2/28/1978	742.12	-26.87%	3/25/1981	1,105	3.03	1,624	4.45
4/27/1981	1,024.05	8/12/1982	776.92	-24.13%	10/20/1982	68	0.19	533	1.46
8/25/1987	2,722.41	10/19/1987	1,738.74	-36.13%	8/24/1989	665	1.82	719	1.97
7/17/1990	2,999.75	10/11/1990	2,365.10	-21.16%	4/17/1991	186	0.51	270	0.74
1/14/2000	11,722.98	3/22/2001	9,389.48	-19.91%	10/3/2006	1,991	5.45	2,419	6.63
5/21/2001	11,337.92	9/21/2001	8,235.81	-27.36%	4/20/2006	1,649	4.52	1,769	4.85
3/19/2002	10,635.25	10/9/2002	7,286.27	-31.49%	11/10/2005	1,111	3.04	1,311	3.59
10/9/2007	14,164.53	10/10/2008	8,451.19	-40.34%	Average=	1,118.83	3.07	1,503.17	4.12

Based on lowest close this year

Bottom		% Change from the Bottom								
Date	Close	1 Mos	3 Mos	6 Mos	9 Mos	12 Mos	15 Mos	18 Mos	21 Mos	24 Mos
6/13/1949	161.60	7.20	13.42	21.79	25.67	40.12	38.25	41.60	52.15	54.72
6/26/1962	535.76	8.18	7.97	21.63	26.99	32.33	37.55	41.89	52.29	55.10
10/7/1966	744.32	7.78	8.65	14.65	16.76	24.78	21.08	16.32	22.61	28.53
5/26/1970	631.16	8.98	20.49	22.74	39.24	43.61	43.56	29.38	46.21	53.88
12/6/1974	577.60	10.32	31.89	45.37	44.73	41.76	68.44	66.88	71.24	66.51
2/28/1978	742.12	2.25	12.07	19.24	8.36	8.99	12.69	19.20	11.90	15.14
8/12/1982	776.92	16.72	33.85	39.85	56.31	52.25	60.92	49.40	48.94	56.78
10/19/1987	1,738.74	9.01	11.36	15.00	20.62	22.92	28.78	37.28	48.64	54.32
10/11/1990	2,365.10	5.22	5.77	22.85	25.14	26.15	35.28	37.64	40.82	32.62
3/22/2001	9,389.48	12.68	12.94	-12.29	6.88	11.06	-1.45	-14.95	-9.35	-9.24
9/21/2001	8,235.81	11.76	21.85	27.25	12.36	-3.03	3.35	3.47	11.72	17.11
10/9/2002	7,286.27	17.17	20.45	12.51	25.66	32.85	43.54	43.31	40.17	38.00
Average % Change=		9.77	16.73	20.88	25.73	27.82	32.67	30.95	36.44	38.62

You can see from the first table that the average time the market took to get from the bottom all the way back to the peak (before the crash) was about 3.07 years (the shortest being 0.19 years, and the longest being 7.80 years). This does not mean that you have to wait up to 7 years to breakeven. Investing close to the bottom means that you can start making profits when the market is half way back up.

My Two Forecasting Mistakes

In the midst of it all, I have personally made two forecasting mistakes this year. I underestimated the impact that the sub-prime crisis fallout had on the major financial companies. Honestly, I never thought that Citigroup, AIG, and Merrill Lynch could have been so badly affected. I lost money

on all three. Once bullish on these wide moat, consistently performing giants, I am not placing any more bets on them as I find them to be risky, with future earnings extremely unpredictable (their business models have changed drastically) and assets very hard to value as well.

My second forecasting mistake was the impact the crisis would have on both the US and Singapore index. I expected only a 20%-30% drop in the Dow as GDP remained positive throughout 2007-2008 (except last quarter) and the US stayed out of recession amidst a weak US dollar (boosting exports) and sustainable consumer spending. At the same time, PE ratios were remained near fair value at 15 times earnings. However, fears from the crisis sent the DOW down 45% and the Singapore Market down 61%.

The lesson here again is that NOBODY can predict the Market direction in the short term consistently. I have been right many times before, but this time, I was wrong. If you read the analyst research on oil prices, half the experts expect oil to crash to US\$20 per barrel while another group of experts expects oil to surge back to over US\$100 as the US dollar weakens (amidst the FED printing money like there is no tomorrow).

This is why, as an investor (as opposed to a trader), you should never base your decisions on short-term market direction. Quoting Warren Buffet, "...I never know where the market is going to go. I never did and I never will. I never need to make such predictions to make money..."

So, if you ask me when the market is going to go up and by how much, I would rather say I DON'T KNOW than to give a forecast. What I do know is that WHAT GOES DOWN, MUST COME UP (even higher) eventually (for fundamentally strong stocks and the index).

However, I am only buying up CASH RICH, EXTREMELY UNDERVALUED, WIDE MOAT, PREDICTABLE (Earnings) stocks that I know will survive and become even more valuable when the market turns around. I am also consistently accumulating the STI ETF, DIAMONDS (Dow ETFs) and the FXI (ETF that tracks China stocks). I will share more in the later section.

The Current Economic Scenario

The US

In the US, Economic weakness intensified in recent months. Unemployment claims jumped by 30,000 to a 26-week high. The jobless rate is widely expected to rise steadily from its current rate of 6.7 percent to 9-percent in 2009 or early 2010. New U.S. durable-goods orders fell 1 percent in November, although it was less severe than feared. Home prices continued to plunge, losing 18% of its value. Although the US has officially recorded one quarter of negative GDP growth (two consecutive quarters of negative GDP growth indicate a technical recession), economists now say that the US actually entered a recession at the end of 2007.

Some economists like Allen Sinai of Decision Economics said the US economy is in for another three to six months of dismal performance; real recovery will wait until 2010. The series of economic stimulus (the creation of 3 million new jobs, interest rate cuts to near zero, government spending of more than \$700 billion) will work, eventually propelling the US economy back to health. However, the property market must first rebound (together with consumer spending) in order to turn the economy around.

The Federal Reserve is projecting real 2009 GDP in a range of -0.2 to 1.1 percent. The full spectrum of economists' views runs from -1.0 to 1.8 percent.

Singapore

Being an export driven economy, Singapore has been hit much harder and faster than the US. Within a few months, our economy has already recorded two quarters of negative GDP growth and sending us into a technical recession on Oct 2008. Because our local stock market is so vulnerable to foreign funds, prices are down more than 61% from the high compared to just 45% in the US. Singapore stocks PE ratios are trading at between 3-9 times, compared to still 8-12 times on the S&P 500.

Although this financial crisis is probably 10 times more severe than the Asian financial crisis of 1997, Singapore (and the rest of Asia) are fundamentally much stronger this time around. I am personally very bullish on Singapore with its strong infrastructure and strong

fundamentals. I believe the stock and property markets have a lot of upside potential once this crisis is over.

Opportunities in the Stock Market

While I cannot accurately predict how long the downtrend in stocks will last or how much lower the bottom could be, I still contend that this is a once-in-a-lifetime opportunity for savvy investors to make their fortunes. The opportunity to buy great companies/properties at huge discounts.

You do not have to buy **AT THE BOTTOM** in order to set yourself up for future profits. You just have to make sure that you buy **NEAR the BOTTOM** and never near the top.

If you study the most successful investors in the world, you will find that what allowed them to build their fortune was **NOT** the decisions they made when the market was booming. Rather, it was the decisions and actions they took during market crisis that made the **BIG DIFFERENCE**.

Buffett made his biggest fortune when he entered the market during the crash of 1973, 1987 and most recently the dot com crash of 2001. These were times when nobody else dared to enter and experts were the most bearish. Sir John Templeton, one of the most respected investors in the world made his fortune by buying blue chip-Dow stocks when they were selling for \$1+ during the great depression.

Quote: "I made by far the best buys I've ever made in my lifetime in 1974. And that was a time of great pessimism and the oil shock and stagflation and all those sort of things. But stocks were cheap." " This is why I'm Buying U.S. Stocks Now".- Warren Buffet, October 2008

To find out what Buffett has been buying up in the last 6 months, you can go to www.gurufocus.com. It is precisely during times of crisis that we must remember these wise words:

" Invest at the point of maximum pessimism" – Sir John Templeton

" Be greedy when others are fearful and fearful when others are greedy"- Warren Buffett

“When stocks are attractive, you buy them. Sure, they can go lower. I've bought stocks at \$12 that went to \$2, but then they later went to \$30. You just don't know when you can find the bottom”. -Peter Lynch, Legendary investor

Singapore versus the US Market

Between the US and the Singapore market, I am actually more bullish on the latter and have allocated a greater weight to Singapore stocks. I believe the Singapore economy is fundamentally stronger and should recover much faster. However, bear in mind that the local market will never take off under foreign funds flow back.

At the same time, Singapore and China present a lot more upside from bottom to peak. While the US is down 45% from the peak, Singapore is down 60%+ and China down 70%+.

What to Invest In

The important thing is to “Play it safe” and “Take minimal risks”. Go for the almost “Sure-Wins” instead of betting on stocks whose future earnings are highly uncertain. Right now, most financial companies have high uncertainty in future earnings as their entire business model has changed and they have a ton of debt to pay down.

Go for companies that have NOT been fundamentally affected by the financial crisis BUT whose stock prices have been battered because of negative sentiment. These stocks will be the first to fly back up once the market turns around.

Here are some additional criteria I now look for (besides the 9 steps you learned at Wealth Academy)- Now more kiasu given the crisis

- 1) Low future earnings uncertainty
- 2) Current Ratio (Current Assets/ Current Liabilities) > 1
- 3) High dividend yield (so I can earn dividends while waiting for stock to recover)
- 4) Stock price < Net Asset Value if possible.

Even safer still is to just invest in the Index. I am personally investing in the STI ETF (Singapore), DIAMONDS (US Index) and the FXI (China Index)

Ultimately, invest with money you do not need to use for at least 3-5 years. Instead of investing everything at a given time, it is wiser to buy consistently every month, averaging the price up or down, since it is almost impossible to buy at the bottom. Taking a long-term view is the only high probability of being profitable

The Stock Market Precedes the Economy

It is also important to understand that the stock market **PRECEDES** (moves ahead) the economy by more than 6-12 months.

For example, the Singapore stock market started its decline on Oct 2007. IT was only **ONE YEAR LATER** that Singapore reported entering a recession on Oct 2008. Similarly, the stock market will start moving up 6 months (or more) before the economy recovers.

So, if the economy is expected to recover only in late 2009-2010, you **DO NOT** invest only when the economy recovers. It will be too late!

Stocks start their bull run **WHILE** the economy is still contracting. By the time the economy booms, stocks are overpriced and start to decline soon after. This is why most people enter too late.

Here are some stats from the last few recessions.

The shaded area represents the time the economy is in a recession. You can see that the stock market (blue line) starts picking up before the recession ends.

Stocks as Leading Indicators at the End of Recessions

1960-1961 Recession

End Date: March 1961

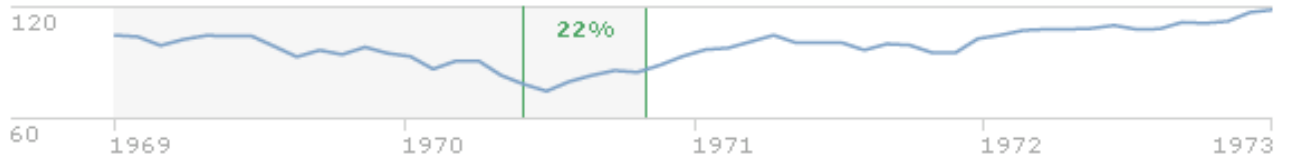
From September 1960 to March 1961, the S&P 500 climbed 20%. Over the next three years, it was up another 25%.



1969-1970 Recession

End Date: November 1970

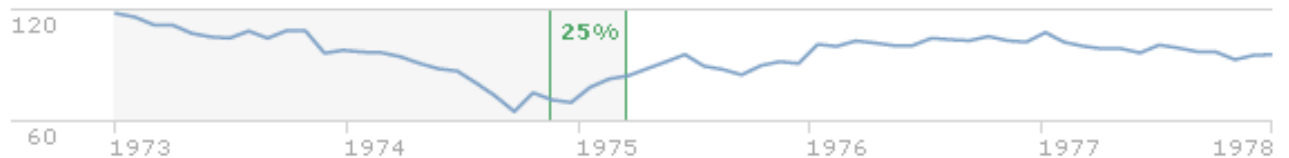
From June 1970 to November 1970, the S&P 500 climbed 22%. It rose another 33% to January 1973.



1973-1975 Recession

End Date: March 1975

From December 1974 to March 1975, the S&P 500 climbed 25%. It had climbed another 20% by July 1977, then stagflation hit.

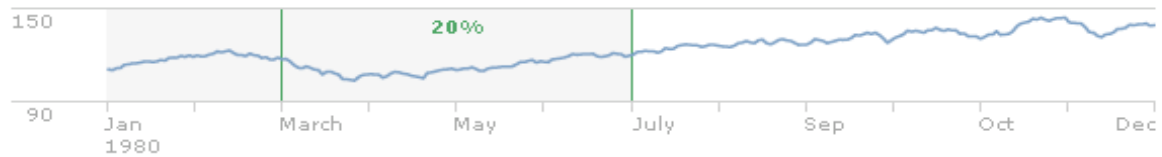


1980 Recession

End Date: July 1980

From March 1980 to July 1980, the S&P 500 rose 20%.

The S&P 500 rose another 15% by November 1980.



1981-1982 Recession

End Date: November 1982

The S&P 500 rose 35% from August 1982 to November 1982.

It climbed another 40% to November 1985.



1990-1991 Recession

End Date: March 1991

The S&P 500 rose 20% from November 1990 to March 1991.

It continued to climb another 25% to March 1994.



2001 Recession

End Date: November 2001

From September to November 2001, the S&P 500 rose 20%.

Stocks fell 25% to March 2003 in a cranky market.



The Property Market

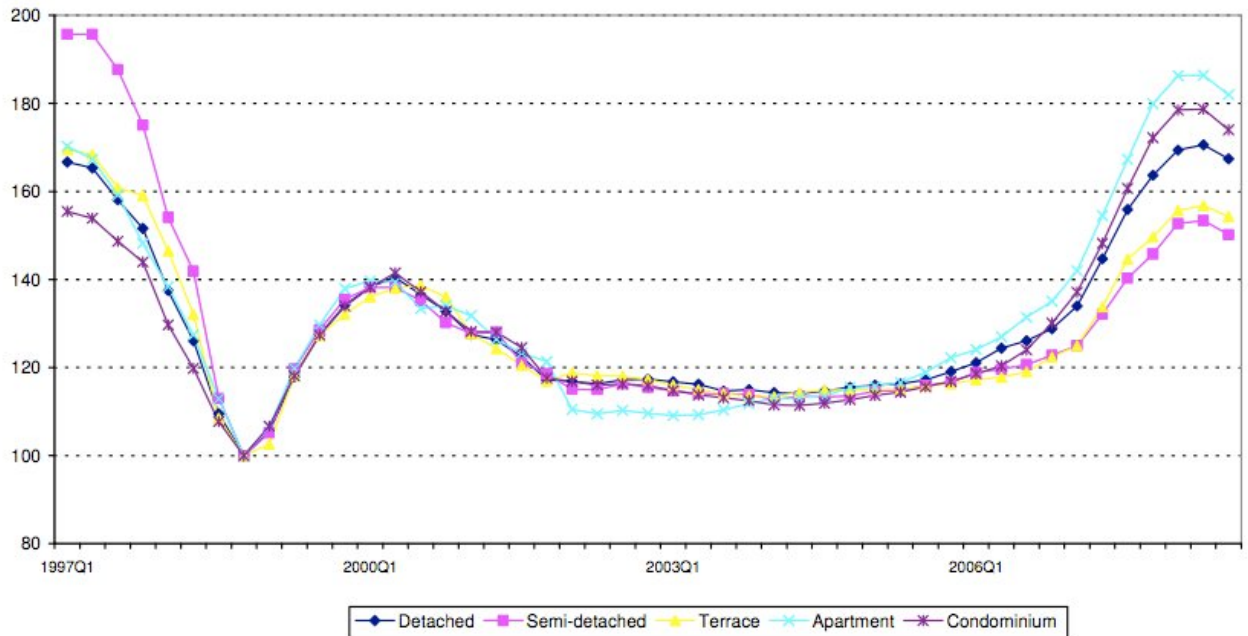
Many people have been asking me about property investing, so here is my take and what I am doing.

I only invest in properties that are undervalued on a PSF basis (compared to similar properties sold in that area recently) AND have a high rental occupancy rate. I only buy when I know the rental can cover my mortgage + give me a bit more cash.

I am personally looking to take advantage of this crisis and pick up a few more properties again. Looking at the chart below, property has also just started its downtrend in prices.

Index (4Q98=100)

Residential Price Index by Type



One thing to note is that the property market is a LAGGING INDICATOR of the stock market. This is why the property market only started going down 3-6 months after stocks declined.

So, property will only bottom 3-6 months after stocks bottom and property will rise only after stocks start their rise.

It is obvious that my money will be in stocks first. I will then take part of my profits from the stock market to enter the property market, just before the next boom. Property prices are widely expected to decline by at least another 20% (referring to private property) for a few more quarters before picking up again.

Again, in the long term, I am very bullish on Singapore property given our targeted rise population to 6 million + (40% increase) in the next few years and our rise as a financial/business hub with low taxes, good government and upcoming infrastructure.

My Strategy

I have also been asked questions about whether it is prudent to borrow money to invest in order to achieve leverage. In general, my answer is 'no'. However, there are a few exceptions.

In my view, never borrow money from these sources for investment:

- Buying shares on margin
- Credit cards
- Overdraft (OD)
- Ah Long

The interest rates are too high and repayment period is too short to be safe. If your investments don't rise in time (a few months), you will get killed by the leverage of losses incurred.

However, given how cheap it is to borrow money now (property mortgage rates at 1.6%), I am borrowing additional money to invest via my private properties I own.

First, I am refinancing my properties to take advantage of the 1.6% interest rates. For every \$1m I have borrowed, I am saving about \$10,000, even after deducting my prepayment penalty.

I am taking equity out of my properties to invest in the stock and property markets during this crisis. In my view, this way of borrowing to invest is low risk. First, by borrowing money at only 1.6%, I am pretty sure that just by investing in the index alone, I can make back a whole lot more in the next few years i.e. 10%-15%. The most important thing is that I am not pressured to pay the entire capital back in the next 1-2 years. I can afford to wait a few years.

Upcoming Wealth Academy Events 2009

I will be soon announcing the upcoming Wealth Academy events and money skills seminars for 2009! We are running at least 5-6 Wealth Academy programs in Singapore and 3 in Indonesia.

I hope to see all of you there at the events and encourage you to volunteer as a coach where you will have the opportunity to bring your knowledge and skills to the next level.

Here's wishing you a great year ahead for 2009.

Adam Khoo

Executive Chairman

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www.Adam-Khoo.com