



## Decoupling, Investment Bubbles and Time Bombs

Dear Reader,

Welcome once more to my e-letter.

Much is happening in the world of finance and economics, perhaps too much, but amongst the almost overwhelming flurry of data and opinion I've zeroed in on a few things that deserve comment.

Firstly, regular readers will know I'm a big fan of spotting trends, and it seems a new one is developing - the world's big emerging economies are finally decoupling from the USA and their reliance on North America as the consumer of last resort.



What does this mean? Simply put, whilst the outlook for the US economy is bleak, optimistic estimates for this year put growth at just 1.5-2%, the BRIC emerging markets are powering ahead with GDP growth forecasts of Brazil 7.5%, Russia 4.25%, India 9.7% and China 10.5%.

For decades the US economy served as the bellwether for the world, but now it appears that these strong, natural resource and human resource rich emerging markets are finally delivering the sort of strong, and independent, growth I've long believed they were capable of.

Secondly, we've seen more than one huge bubble burst in the last few years so let's pay very close attention to the next overcooked investment - bonds.

As with the US decoupling, for many investors it may seem strange to hear that a risky bubble is building in bonds, but it is really happening, and easily explained - demand for safe haven bond investments in these uncertain times has skyrocketed thus pushing up prices.

And when I say bonds, I mean both corporate or government, and I ask all investors to look very closely at their exposure to bonds. As ever there are always alternative homes for capital. Switching to cash will keep the low risk portion of your portfolio safe in the short term, equities are cheap and gold should perform well if, but most likely when, the US begins QE2 - Quantative Easing 2 - i.e., printing lots more money.

As with all looming corrections, there are many opportunities to exit whilst the bubble is still inflating, and this might well be such a time.

Indeed, with that in mind, this week I'm focusing on pension planning, and amongst other things, how to avoid seeing your retirement nest egg swallowed up by a bursting asset price bubble.

The Pension Time bomb: how to avoid it blowing up in your face.

For once, there is a media scare story that is based on truth. Forget bird-flu, mad-cows and the imminent collapse of life as we know it - the so-called Pension Time Bomb is very, very real indeed.

So what's the problem? In short, developed world populations are ageing, birth rates are falling and the dependency ratio (workers to retirees) is shrinking. People are also living longer, but, crucially, they are saving less and less, typically in the misguided belief that their firm or state will provide for their old age.

And whilst extended longevity is wonderful news for the individual, it's a disaster for the governments charged with providing some form of state pension for this burgeoning army of senior citizens.

Or to put it another way, ***a state pension is really just a big Ponzi scheme*** - and like any pyramid selling trick, if there are not enough punters paying in at the bottom, then there's nothing to skim off the top.

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So if the state can't help, maybe the company can ride to the rescue.

True enough, many of us forget, or are too young to remember, the days when people joined a company from school and immediately went into its pension scheme. If they stayed with that company for 30 years or, as was common, all of their working lives, they could look forward to a decent retirement fund.

Well, unfortunately, those cosy days are well and truly gone and if you do not address your retirement planning early, you might well be looking at some very stark choices later in life.

The options would then include pushing back retirement, or, worse, simply working indefinitely.

But this begs the question, where would you prefer to be aged 65? Sat behind the wheel of a golf-buggy or behind the wheel of a taxi, working the night shift. Do you want to be in the DIY megastore shopping for garden furniture, or selling it?

Or, if you own a property you could remortgage, and spend your way through your grandchildren's inheritance.

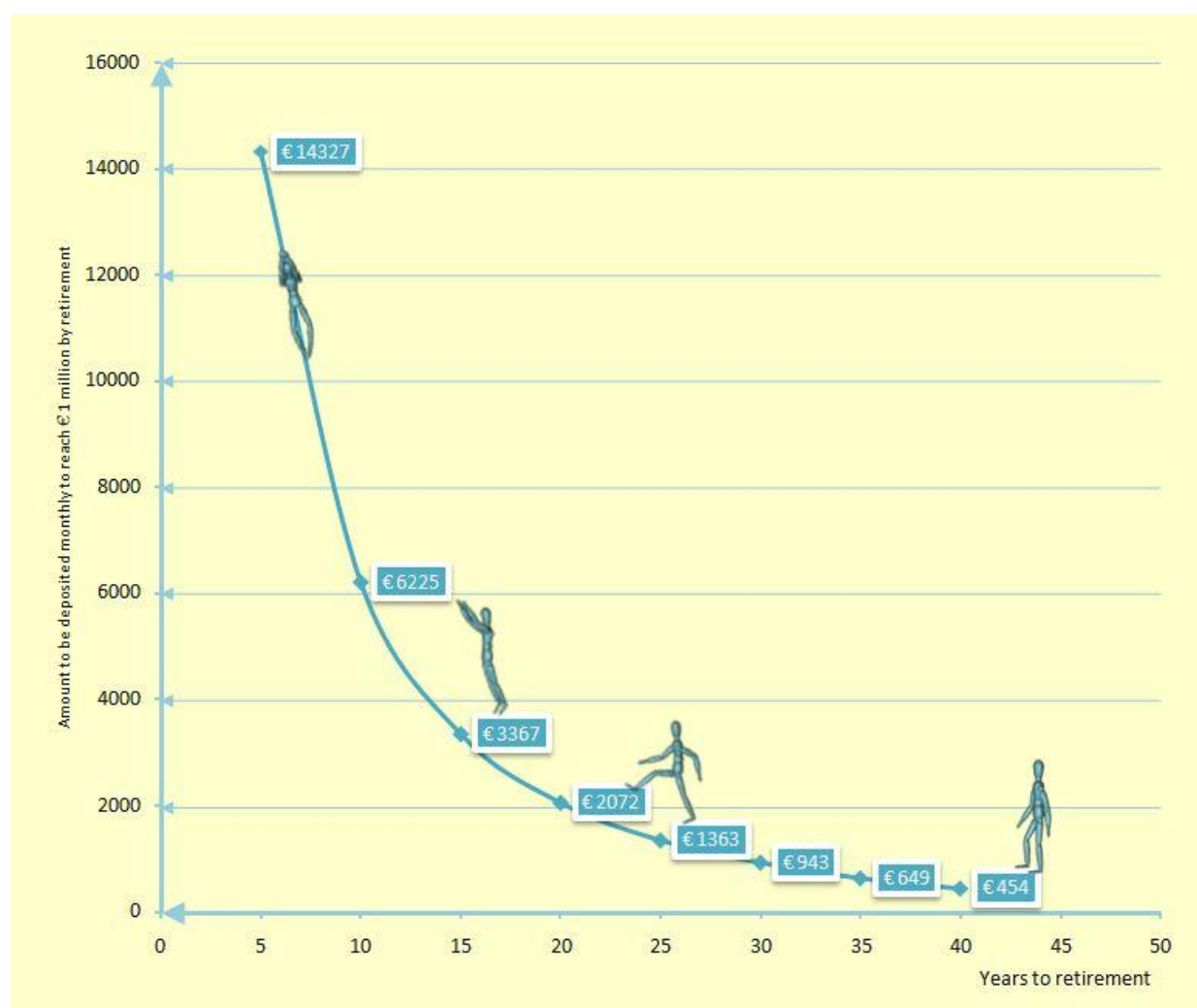
Whatever happens, a lack of planning now could mean having to lower your expectations and realise that retirement is not going to be the walk in the park you perhaps envisioned.

## The cost of delay

One of the most useful ways that financial planners can assist their clients is helping them to avoid common mistakes. Behavioral finance experts suggest that most of these mistakes are predictable and are essentially hard wired into human beings.

Indeed, a good example of this is the delaying of retirement planning: most people overvalue the importance of immediate income and undervalue, or even worse, ignore, future income needs.

And as the graph below shows, the cost of that delay is very real and very large.



What the graph shows is that securing a retirement fund of €1,000,000 - assuming an average compound return of 7% per year - requires a monthly investment of €454 if started early, (say at the age of 25, with 40 years to retirement at 65).

Delay that by a mere 10 years and you will need to find €943 per month. Push it back another 5 years, and it rises to a monthly outlay of €1363.

In fact it soon starts to ramp up, and will feel like pushing a big rock up a steep mountain.

If you leave it 15 years before you plan to retire, then make sure you can find €3367 per month to pay into your retirement fund.

Leave it a further five years, and you're now looking at €6225 - and don't forget this exponential rise started at €454 - which is beginning to look like Mission Impossible.

So, what can be done? As usual simple problems breed simple solutions: Start saving and planning, and do it yesterday. Or at the very least give the matter some thought, starting with ball-parking a figure of how much you think you might need to retire in comfort.

By way of example, the 2006 U.S. Retirement Confidence Survey found that just six out of ten Americans say they are actively saving for retirement, whilst only four out of ten have actually calculated how much they think they might need. That's a lot of guesswork.

In fact, it's highly likely you have a good career and quite possibly a good company pension plan. And to be sure, many people in such positions think that the company pension plan will be sufficient.

But look again at how global equities - which is most probably where that company pension is invested - have just tanked. Indeed, envisage your own retirement pot reduced by a quarter - which is what has happened to many such company plans over the last few years.

Safe as houses?

Of course there are those wealthy enough to retire in comfort tomorrow. And there are also those that have chosen to invest heavily in property, in the belief that nothing beats bricks and mortar.

This is a sound idea. Unless however, the individual has all their retirement fund money locked into multiple property investments, and, as we have witnessed in the UK, the bottom falls out of the housing market.

This then proves the wisdom that overloading on a good investment idea is a very easy way to turn it into a bad one - suddenly your retirement nest egg is a heavy, illiquid burden and old-age looks a little less fun with 40% less cash in the bank.

And furthermore, don't think that the first group - the wealthy - are immune to miserable old age. They are not.

**It's short-sighted to think that the company you work for today is the one that will be sending you fat cheques in your twilight years.**

The one sure thing in life is that anything can happen, and often it does. An expensive divorce, a failed business or an ill-judged equity gamble, fraud, theft, or poor-health can all reduce mountains of seemingly Teflon coated wealth to molehills of small change with dizzying speed.

So, be smart. Think ahead. Given today's dynamic labour markets, accept that it's naive to presume the company you work for today is the one that will be sending you fat monthly cheques in your twilight years.

Also accept that loading up on one-way bets on single asset classes (such as sinking your life's savings into houses or equities) is equally ill-advised. As is piling your cash into the bank and leaving it there.

The absolute bare minimum we should be looking for of any investment or saving is that it beats inflation and bank interest rates on sterling deposits over the last 25 years have failed to maintain purchasing power.

In short, the choice is yours. I believe that nobody wants to struggle financially, the reason many people do when approaching and during retirement is procrastination. I also believe the best course of action is to talk to a financial planner and review where you are today and where you want to be in the future, formulate a plan and implement it.

Then you can sit back and imagine enjoying your old or even your not so old age, your grandchildren, and the fruits of a lifetime of work - after all, you've earned it.

I am a UK qualified financial advisor. If you would like to discuss any of the issues mentioned here or have any questions etc please contact me on +361 354 0010 or [e-mail me](#)

Best wishes,  
Richard Holmes  
CEFA  
FAIQ (CII)



Hajós utca 31.  
Budapest, 1065

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