Thoughts from

Hanson Investment Management Inc.

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An Asian Trip . . . Some Miscellaneous Thoughts . . .

I AM JUST BACK FROM A TRIP to India, Sri Lanka and Laos. My thoughts on the Indian economy and market are on pages two and three. Here are some miscellaneous travel tips.

1. **If Singapore is your destination…** try the new Singapore Airlines (SIA), Newark to Singapore non-stop flight, eighteen hours and thirty-five minutes in the air! Not only is the experience humanly possible (I even went coach) but also remarkably comfortable. SIA configures the new Airbus for just 180 seats. More space for everyone. And while in Singapore don't miss the classic dish, chili crab (whole crabs simmered in a spicy chili sauce). An excellent location is the Palm Beach Restaurant, downtown on the waterfront.

2. ***Consumer Reports*, move over…** The *Christian Science Monitor* reported in early 2003 that nine out of ten cars on the streets of Kabul, Afghanistan are late model Toyotas. My experience in Laos is the same; all the cars are late model Toyotas. What gives? Maybe that only the strongest cars survive and these are the ones that get to the last markets, Kabul and Vientiane. I haven't seen a Cressida or Corona in decades. You will in Laos. Toyotas are the real deal!

3. **The ultimate Asian adventure…** if you have just one trip to South Asia and want to get off the beaten path here is my vote for a spectacular adventure. Luang Prabrang in Laos is the old royal capital being beautifully restored with the help of the French. Angkor Wat in Cambodia is a complex of two hundred temples. It is simply in a class by itself. And finally, Bagan (pronounced Pa-gaan), Myanmar is a series of 3,000 Pagodas stretching over twenty miles. A once in a lifetime trip and all very accessible from Bangkok!

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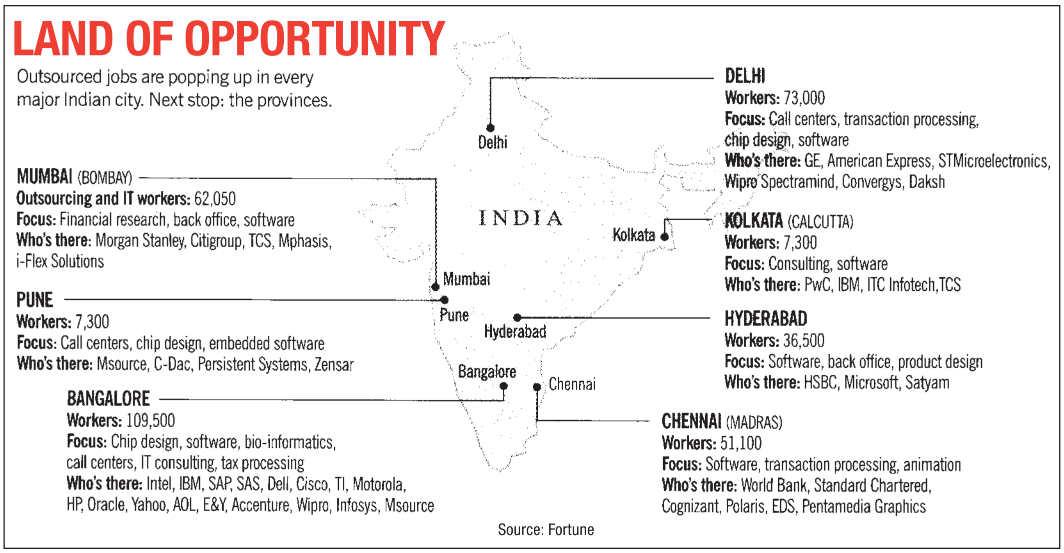
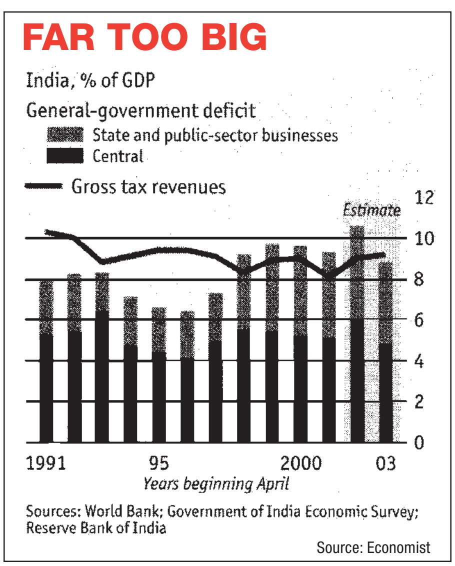
Hanson Investment Management is an investment counsel firm managing portfolios for individuals and institutional clients. The firm also consults with individuals on financial planning and works with self-directed retirement plans on investment options.

India . . .

Nothing Can Quite Prepare You . . .

INDIA IS ALL ABOUT EXTREMES. Nothing can quite prepare you for the drive from downtown Bangalore to Electronics City, one of the country's original high tech parks on the outskirts of town. The road out is a sea of bullock carts, taxis, bicycles, motorcycles and scooters, ancient public buses belching black smoke – utter confusion in a sea of people and more people. Infrastructure is the Achilles heel of India and always has been. Power outages, clogged roads, inadequate sewers and lack of potable water – you wonder how the country works at all.





But work it does. Get to Electronics City and you are in a different world. India has taken its world-class engineering higher education system, coupled it with a long history of English and a thriving entrepreneurial spirit and built an incredible Information Technology service sector. Companies like Infosys in Bangalore and Tata Consultancy and hundreds of others have carved out an important niche servicing American and European IT needs. First it involved sending Indian workers on short-term contracts to the U.S. Then with satellites and broadband internet connection, Indians could stay home and use the 12 hour time differential with the U.S. to create a seamless 24/7 IT service center.

Y2K fears fed more business at the end of the last decade and today systems integration, design engineering and consulting are some of the big drivers of growth. *The chart in the upper right* shows successes of the past and where things might go in the future. It is interesting that the most controversial part of IT outsourcing, the call center, is the low end of India's expertise. Call centers will eventually be India's past. The high end is the name of the game from here.

Total IT employment in India is probably 1 million people. This is impressive but still just a small drop in a country of over 1 billion people. What are the prospects for India outside of IT? I was last in India on business in 1994. At that point I was impressed with the growth of the Indian middle class. Now I am amazed. It is estimated that the country has between 250 and 300 million people earning $6,000 U.S. or more a year. These families are able to afford things just dreamt about ten years ago. $6,000 goes a lot farther there than here. A 4-door entry level Suzuki car costs $4,000 and a top selling Honda motor bike $1,000. Cell phone service can be had for $7 a month.

Supporters of India say the development story is all about demographics. India will grow because it has a rapidly expanding base of 15-40 year olds who will fuel consumption and the new middle class. But it takes only one trip to India to see that demographics is also a sword of Damocles. The country will never catch up in infrastructure if population is not controlled. Demographics may bring you a growing consumer class but it also brings you physical and environmental gridlock.

Companies are paying close attention to the consumer in India today. At the high end Himatsingka Seide is an Indian manufacturer and designer of expensive ($100-150 a yard) silk curtains and upholstery fabric. Ten years ago they did no retail business in India. It was all in New York and Europe. Today they have a chain of home furnishing stores in major Indian cities. At the other extreme Hindustan Lever the Indian subsidiary of Unilever is marketing individual packets

WHERE INDIA IS MAKING AN IMPACT

SOFTWARE	IT CONSULTING	CALL CENTERS	CHIP DESIGN
India is now a major base for developing new applications for finance, digital appliances, and industrial plants.	Companies such as Wipro, Infosys, and Tata are managing U.S. IT networks and re-engineering business processes.	Thousands of Indians handle customer service and process insurance claims, loans, bookings, and credit-card bills.	Intel, Texas Instruments, and many U.S. startups use India as an R&D hub for microprocessors and multimedia chips.

... AND WHERE IT'S GOING NEXT

FINANCIAL ANALYSIS	INDUSTRIAL ENGINEERING	ANALYTICS	DRUG RESEARCH
Research for Wall Street will surge as U.S. investment banks, brokerages, and accounting firms open big offices.	India does vital R&D for GE Medical. GM, engine maker Cummins, Ford, and other manufacturers plan big engineering hubs.	U.S. companies are hiring Indian math experts to devise models for risk analysis, consumer behavior, and industrial processes.	As U.S. R&D costs soar, India is expected to be a center for biotechnology and clinical testing.

Data: *BusinessWeek*

Source: Business Week

of shampoo to the low end market. Banks are experimenting with ATM machines which dispense ten rupee notes, the equivalent of a U.S. quarter. The poor have tremendous buying power. The trick now is tapping it.

A common question today is, will China or India be the winner in the Emerging market development battle? Business people who have visited both countries usually give the hands-down advantage to China. The country is attracting more foreign direct investment (FDI) than any country including the U.S. *(see chart at the bottom)*. India's FDI take is paltry so far. In addition China's centralized decision making system, albeit a one party communist model, is more decisive and efficient than India's messy democratic model.

My take is both China and India can be successful. One does not have to lose for the other to win. China will continue to develop as a manufacturing center for the world. Most Indians I spoke to are pessimistic that India can develop the infrastructure or the economies of scale to rival their neighbor to the north in manufacturing. At the same time however it will be difficult for China to seriously erode India's lead in services. India produces 300,000 well educated English speaking engineers a year and these graduates are in big demand. In fact the problem is costs are rising rapidly now. Experienced personnel are in short supply and turnover at many IT companies is running 20% or more as employees get poached. India should stay competitive for many years but its challenge will be to produce companies which can ramp employment from 30,000 (Infosys, Wipro and TCS today) to the 100,000 level to compete with the Accentures of the world. India also has to prove it can continue to move up the skills ladder from call centers and lower end work to sophisticated high end consulting.

The stumbling block in all this is pretty clear – governance. India needs to get the basics right. It needs to have sound fiscal policy (spending and taxes), it needs to have transparent and consistent regulation and it needs to stay stable. These are all big ifs. The country is currently running a combined federal and state budget deficit of nearly 10%. This needs to come down. It is estimated that all of the Government's money is eaten up each year by just four spending categories: defense, interest on the debt, subsidies to farmers and the cost of public servants. There is very little left for education and the all-important infrastructure projects like roads and clean water and electricity. Indian democracy is very messy and it is difficult for the country to stay on course. The defeat of the BJP in the recent Federal election by the more populist Congress party has many worried that the hard won economic reforms of the past 20 years will be rolled back. I am more confident here both that globalization is here to stay and that India can stay on track but there will be ups and downs.

How do investors play India's growth? There are Indian companies listed on the New York Stock Exchange and NASDAQ. Outsourcing giants such as Wipro, Satyam and Infosys all trade here. Unfortunately the shares reflect the success of IT and the Indian companies trade at 25X earnings or higher. No great bargains here. To play the growth of the Indian consumer and infrastructure development, country funds are a good bet. The India Fund on the NYSE (symbol is IFN) is one we have used. It has done well the last year increasing 50%. The time to buy India is when the story completely unravels. Emerging markets are very volatile and they do tend to drop sharply once or twice a decade. That is when to load up. But now is the time to get your list ready and India should definitely be on it.

Competing Giants

	Population (2002)	Population Growth Rate (2002)	Infant Mortality (2002)	Average Annual Real GDP Growth Rate (1990–2000)	Foreign Direct Investment (2001)	Population in Poverty (2002)	Labor Force (1999)	Fixed Lines and Mobile Phones (2001)	Size of Diaspora
China	1.28 billion	0.87 percent	27 (per 1,000 live births)	9.6 percent	$44.2 billion	10 percent	706 million	247.7 (per 1000 people)	55 million
India	1.05 billion	1.51 percent	61 (per 1,000 live births)	5.5 percent	$3.4 billion	25 percent	406 million	43.8 (per 1000 people)	20 million

Source: Foreign Policy

The U.S. Economy . . .

Social Insecurity . . .

IN OUR RETIREMENT PLANNING work, I am always surprised to find out how little most folks know about Social Security. True, most people have a general sense that the program is designed to provide modest retirement benefits but few understand who is covered and by how much. Further, thanks to decades of bad press, many seriously doubt whether the system will survive into the next decade.

Today, 47 million Americans receive some form of Social Security benefit. Originally the program was designed to partially replace lost earnings in the event of retirement or death. But significant changes over the years have added programs providing disability and health care benefits as well. Today only about 62% of Social Security checks go to retired workers. The remaining 38% is split between survivors, family dependents and disabled workers.

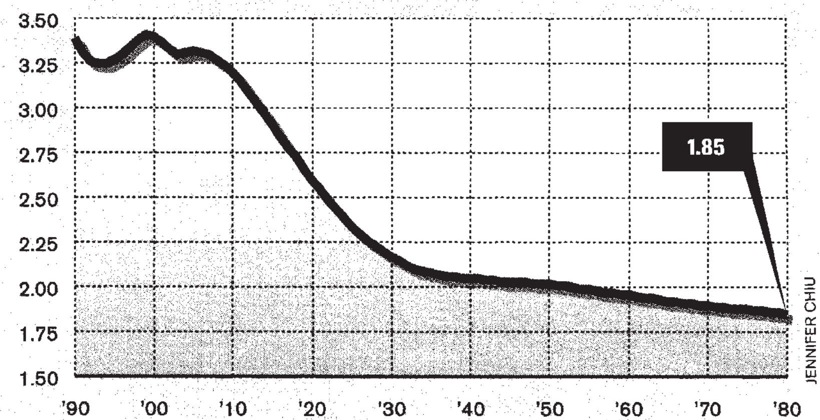
Generally to receive payments, you must be over 62 and have at least 10 years of part time work experience. But even current and former spouses, dependent children and parents without sufficient work experience may qualify for benefits.

How much will you receive? Payments are based on the amount of money you put into the system and the age at which you start to draw benefits. Generally, your checks will be roughly proportional to your lifetime earnings and payments into the system. While the computation is somewhat complicated, the average worker can expect their Social Security check to equal about 40% of their average indexed earnings over the last 35 years. To put this in perspective, the maximum amount payable to a 65 year old in 2001 was $1,536/month and at that time the average retiree drew $845/month.

In addition, the earlier you start to receive benefits, the lower your monthly checks. Age 65 is considered the normal retirement age (NRA) for those born before 1937. But the government is now gradually increasing the NRA to 67. Clearly, Social Security should never serve as a primary retirement vehicle but it can represent an important component of a retiree's overall financial resources.

ON THIN ICE

Number of workers per beneficiary covered under the Old-Age and Survivors Insurance Trust Fund and the Disability Insurance Trust Fund



2004 Trustees Report's best estimate of the trust funds' future financial outlook

Source: Social Security Administration

Source: Investment News

Social Security's demise has been widely predicted for years. Increased longevity, the growing number of retiring baby boomers and stagnant birth rates are putting the system into a demographic bind. Combined, these trends have caused a significant drop in the ratio of workers available to support each beneficiary. Back in 1940s, there were 10-15 workers for every beneficiary. Today the number is closer to 3.1 and by 2050, it is expected that there will be just 1.5 workers to support every recipient. Current estimates hold that the Social Security trust fund will run a surplus until 2025. At that point, benefit payments will begin to eat into the Fund's accumulated surplus. By 2037, all surplus funds will be exhausted and estimates suggest that payment levels will have to drop to 70% for the rest of the century.

Interestingly, the solution to Social Security's financial dilemma is not that complicated. To achieve solvency, the government must raise taxes, cut benefits or increase the rate of return earned on invested assets. Numerous partisan and non-partisan studies have attempted to arrive at a solution. One by the Advisory Council on Social Security found that a 0.9% tax increase on both employer and employee contributions would eliminate the entire shortfall.

While I may be an optimist, I am not too worried about Social Security's long-term solvency. With 1 out of 6 Americans receiving benefits and 149 million paying into system, I think Social Security is simply too big to fail. The more important question remains when will it be fixed and at what economic cost. But it is important to remember that we have been here before. In the 1970s, a combination of surging inflation and rising unemployment caused the system to run deficits. Attempts to solve the problem failed in 1977 but in 1983 Congress raised taxes and decreased benefits sufficiently to keep the system operating soundly for the next 50 years. The solution to the current Social Security funding dilemma is best found in the Chinese proverb: *"Take care of what is difficult while it is still easy."*

–Anne W. Doremus, CFA