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Quant at Work

Special report

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Asia
Quantitative insights

Want to see into the future?

- **Demographics a key long-term driver for Asian valuations.**
- **PE ratios depend on supply and demand of retirement-planning investors.**
- **This explains the valuations global investors have paid for earnings over the past half century or more.**
- **Asian indices to enjoy long-term gains, while US market flounders in their wake.**

Our original report

Boomers & markets 2

Real-life stories of Boomers in action

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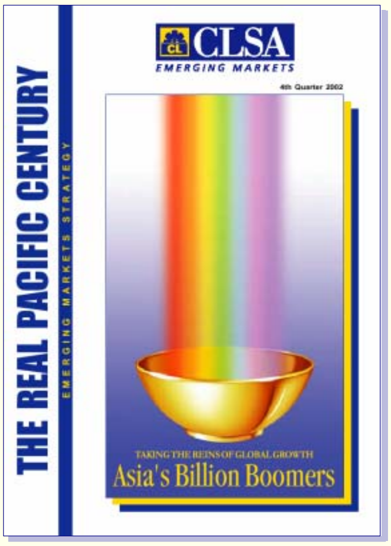
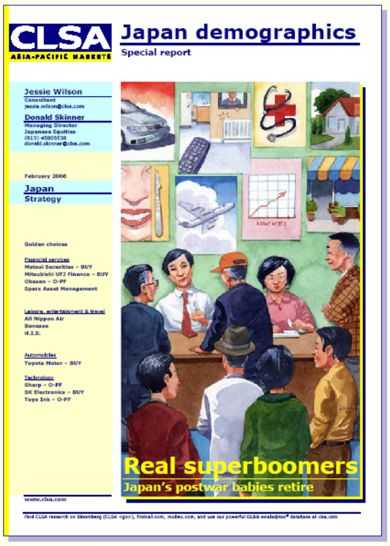
Further reading on Asia's *Billion Boomer* demography

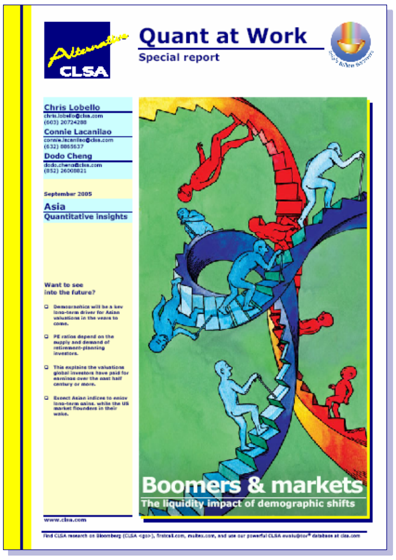




With our seminal *Asia's Billion Boomers* report, in the fourth quarter of 2002, we introduced the thesis of the region's next economic driver - private consumption.

Want to see into Asia's future?

Two years ago we asked precisely this question in *Boomers & markets - The liquidity impact of demographic shifts*. The report identified the changing demographics of Asia's Billion Boomers as the main, underlying, long-term driver for its equity markets. This was *not* ascribed to the change in the consumer/earnings landscape, but instead linked to the interaction of Asia's prepping-for-retirement boomers with their own stock markets.



With markets bouncing downwards on the back of US subprime concerns and the subsequent impact on sentiment and liquidity, it might seem that an examination of long-term drivers and investment trends is misplaced. Yet, two years on from our original report, Asia's markets have largely pushed in the forecast direction, with boomers leading the way through increased domestic participation and higher valuations. This structural shift will continue, and it will play a significant role in determining the valuations investors are willing to pay for Asian equity.

To understand exactly how much of this push is coming from Asia's demographic shift and a growing domestic investor base, we revisit the topic with a look at the action on the ground from Seoul to Taipei to Tokyo. The bottom line is that the valuation-driving medium-to-young ratio (MY ratio, explained shortly but largely what you'd expect), suggests rising valuations in most of Asia and, crucially, falling valuations in the US. While the short-term volatility will come and go, long-term omnipresent trends will set the direction around which that volatility will bounce. Read on to learn what this key market driver is all about, what it means for Asia, and to see examples of "Boomers in Action".

What this is all about - The full report in 30 seconds

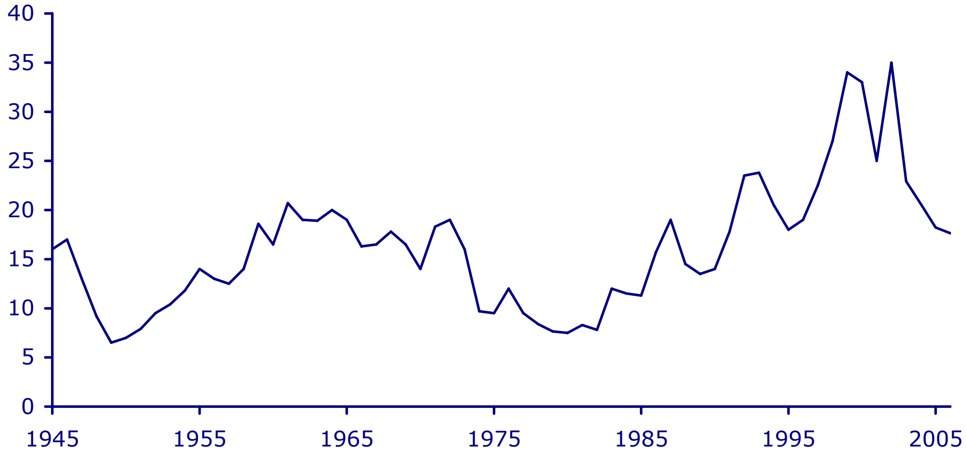
- **Supply and demand push prices. All else being equal, an increase in demand leads to higher prices.**
- **The same applies to equities.**
- **Demographics matter. When you are 20 and "immortal" your money goes to wine, flashy gear and song. When you hit 40 you worry about running out of wine, flashy gear and song at age 60, so you start saving and investing.**
- **If enough people hit 40 at about the same time, that increases demand for investment vehicles, so prices and PEs go up.**
- **Asia's demographics are shifting towards these middle-aged investors, who should drive markets higher from their own domestic and intra-regional investment. The US is just finishing a long market run which was largely driven by this effect.**

Predicting valuation multiples with MY

One of the difficult tasks of investing is not just getting the earnings predictions right, but knowing where PE ratios are going. Over the past century, changes in PE ratio have done more to drive stock market returns than changes in earnings, and these valuations are all over the place. Looking back at the US market since the end of World War II, PEs have been as low as 5 and as high as 35.

Figure 1

US: S&P PE ratio

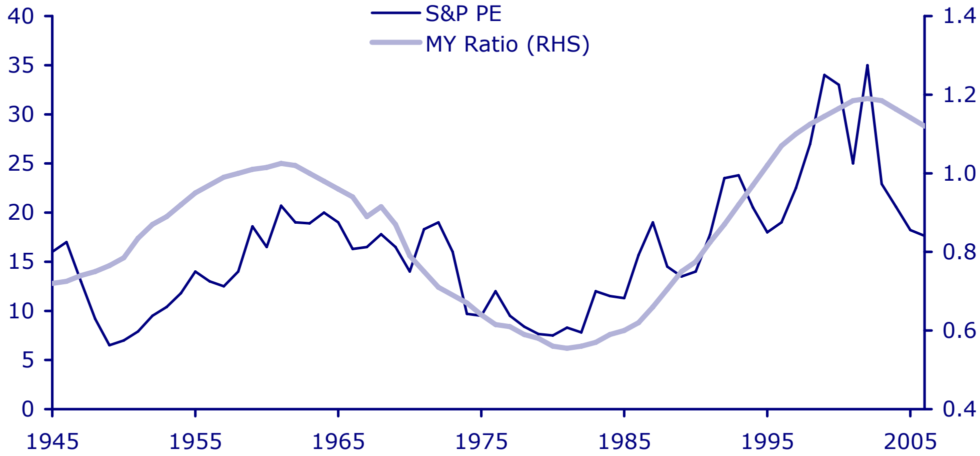


Source: *Demography and the long-run predictability of the stock market* - Cowles Foundation, CLSA Asia-Pacific Markets

Imagine if someone drew a line showing what they thought the PE ratio would look like over the next 20 years, and their prediction proved accurate. You'd likely think of them as a freakishly good forecaster of long-term future trends.

Figure 2

US: S&P PE ratio vs MY ratio



Source: *Demography and the long-run predictability of the stock market* - Cowles Foundation, CLSA Asia-Pacific Markets

Well, such a forecast is nothing more than the MY ratio, a measure of the demographic "bulge" of the greying middle-aged (including myself as a newly minted member of the M category) who are the prime drivers of investment cycles. We can use this ratio to directly measure how the demand for retirement-driven investment directly influences market valuations. And the most interesting thing is that for the next five, 10 and 15 years, the MY ratio suggests that Asian valuations and prices are going up, while those in the US will fall.

Booming market buyers

What is this MY, and what does it tell us?

From the US bull market of the 1950s to the more recent index run of the 1990s, contemporary explanations of a climbing market hold two commonalities – a technology-based change that leads to the belief that 'this time things are different', coupled with a view that more people are putting their money into the market. The addition of new market players helps to push index levels and valuations higher as a broader investor base creates and feeds upon its own growing demand for equity. In other words, liquidity matters.

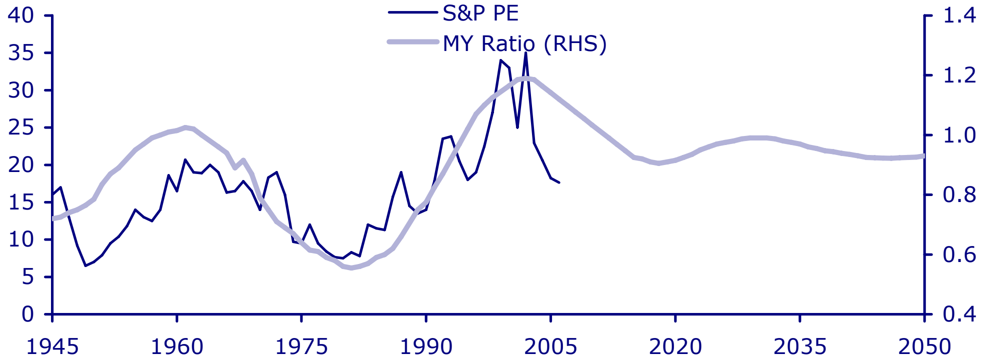
Conventional wisdom holds that an ageing baby-boomer generation was a key part of the US equity markets' appreciation that characterised the 1980s and 1990s. This same view further suggests that markets could be in for a fall when boomers begin to cash in their portfolios to fund their dream retirements. But is there any truth in this conventional belief? And if so, how strong would the effect be, and to what degree would markets respond? And if people are anticipating the impact, wouldn't it already be in the price? Finally, how would Asia fare?

There are various views and studies of these questions. One of the more comprehensive of these not only looked at the theoretical expectation of how markets should work, but reviewed more than a century's worth of data as to how markets function. The Cowles Foundation study, *Demography and the long-run predictability of the stock market*, examines the empirical evidence over several decades of cycles in US population and markets, and finds a striking link between demographic patterns, real returns and PE levels.

The Cowles study argues that since the turn of the 20th Century, the US has seen a cyclical boom and bust in birth rates with a period of roughly 40 years – the most notable of these being the Post-WWII Baby Boomers – and that the relationship of these cycles to equity returns is strong and consistent. Let us return to Figure 2 and look at the link between the MY ratio – a measure of how much "bulge" there is in the middle-aged portion of the population - and the trailing PE ratio of the S&P 500.

One of the most difficult aspects in long-term forecasting is understanding how much investors will be willing to pay for earnings. Much more of the global equity return for the past century has come from an increase in the price paid for earnings than in the actual growth in underlying earnings. As such, any insight into where this willingness to pay for earnings is headed will give a strong lead as to market direction. Looking at both the logic of demographics and decades of empirical evidence, the MY ratio is a strong indicator of market direction.

Figure 3
US: S&P PE ratio vs MY ratio



Source: *Demography and the long-run predictability of the stock market* - Cowles Foundation, CLSA Asia-Pacific Markets

The MY ratio looks at the proportion of those that are arguably the most prone to invest for a coming retirement (taken as those between 40-49) compared to younger earners (those from 20-29) who are perhaps more concerned with the new car and the plasma TV with attached *Wii*. Part of this added savings for retirement from the older group comes from inclination and concern, and partly from higher salaries generally seen later in the working career.

In the period shown since WWII, the MY ratio appears to have risen and fallen in tandem with the amount investors are willing to pay for earnings (see Figure 2). This substantiates the theoretical claim that swelling ranks of investors end up chasing markets and paying more for their investments.

Of course, looks can be deceiving, and as such the authors of that study employ regression analysis to measure the strength of the relationship between the MY ratio and PE ratios. First they look at the full period of 1910-2002, then at the period of 1945-2002 for the post-war effect, and finally, they measure the 1965 period where the current crop of America's Baby Boomers started to move into the MY ratio. The statistics show a strong linkage between the MY ratio and the market PE ratio, and further analysis demonstrates that this linkage appears to be driven not by any demographically linked shift in earnings, but by people paying more for their investment opportunities as demand for retirement investing increases. For more details on the findings, please see our original report, *Boomers & Markets - The liquidity impact of demographic shifts*.

Figure 4

US regression of PE ratio on MY ratio

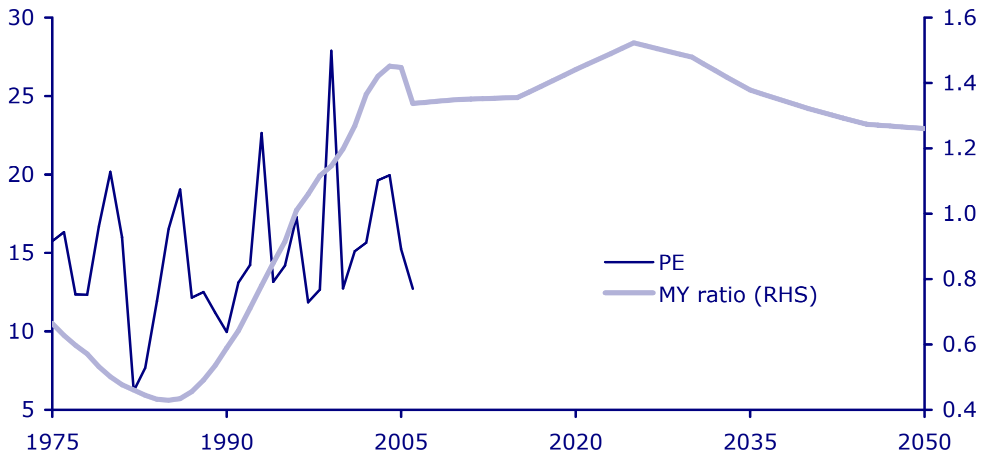
	c	ß	R^2	ADF t-stat
1945-2002	(5.5)	25.4	0.55	(2.8)
1965-2002	(7.1)	29.7	0.78	(4.8)

Source: *Demography and the long-run predictability of the stock market* - Cowles Foundation, CLSA Asia-Pacific Markets

Where does Asia fit in?

Our 2005 *Boomers & Markets* report built upon the Cowles Foundation study by applying the process to Asia. Here the task was hampered by equity markets' much shorter history. As our original report noted, Hong Kong's data only dates back to 1975, a time when CLSA's own Richard Witts was head of the Hong Kong Stock Exchange in the esteemed role of secretary and general manager. As is evidenced by Richard's continued participation in that same market, this data offers considerably less than one generational cycle for observation, but for the time we do have, the available numbers fit well with the US findings. In Hong Kong and the US, market performance appears to be linked to the MY ratio.

Figure 5
Hong Kong: Real HSI vs MY ratio



Source: HK Census & Statistics Department, United Nations, CLSA Asia-Pacific Markets

As the bump of middle-aged populations moved up, so did the market. Certainly there was great market volatility around that trend, particularly from 1990 forward, but the general movements and levels were in sync. Had a market strategist sat down with Mr. Witts in 1975, drawn the MY chart and labelled it a prediction of market moves to come, he would have been lauded as an expert long-term prognosticator. Anyone following such a curve would have raised allocations to Hong Kong in the late 1980s, a time when the real price index was moving to sharply higher levels. Certainly there are multiple factors pushing the market, ranging from China's emergence to politics, but the evidence supports the view that the MY ratio is one important contributing factor.

Not surprisingly, a regression analysis finds a strong and notable link between MY levels and the altitude of the real price index for the market. After all with earnings smoothing over the long-term to run in line with overall economic development, valuation multiples are the key driver to performance and price level. While there are definite caveats to the comparison of these levels, certainly any effect that appears to explain roughly three-quarters of long-term market levels – and to do so with hefty statistical strength – is worthy of investors' attention.

Figure 6
Hong Kong regression of real HSI on MY ratio

Constant	(1,824)
Coefficient	12,396
Adj R-square (%)	71.7
ADF t-stat	(3.39)
No. of Samples	32

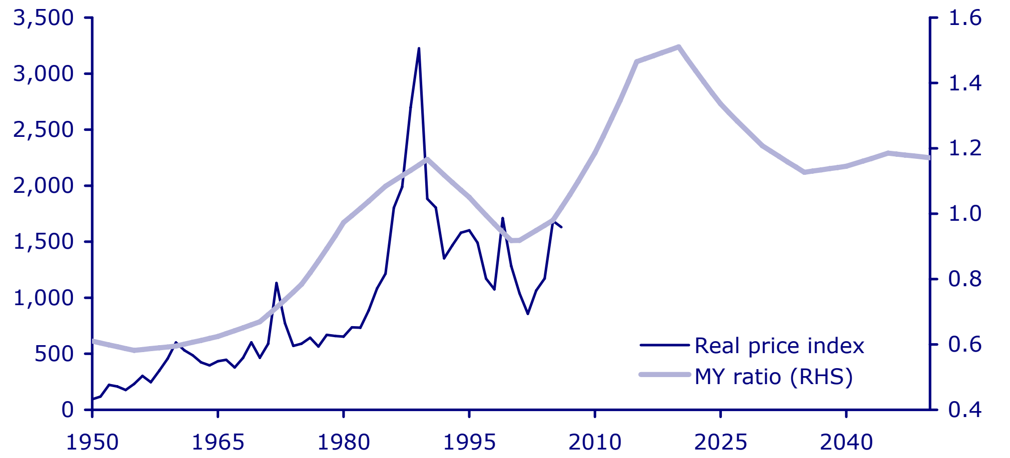
Source: CLSA Asia-Pacific Markets

It is perhaps surprising, but Japan shows a similar effect. If there is any major global market which might be considered to have a peculiar and unique demographic pattern, it is Japan, as can be seen in previous CLSA reports such as *Going for Silver – Opportunities in Japan's greying market* (September 2004). As the first of the recent major economies to deal with shrinking populations and with a unique post-war birth pattern, Japan's demographic profile differs notable from that in the US and other major markets.

Despite this difference, with data starting in 1949, we again see that on a long-term basis the index and the MY ratio moving in tandem. Of course, it is here that the potential for medium-term deviation between the two is best displayed, as the market tear of the late 1980s well overshot the increase one would expect simply due to demographic upticks. This reiterates that while demographics are important, they are far from the only market driver, particularly in times of liquidity-driven excess. It is interesting to note though that the overshoot came after a period of the Topix real price index trailing a demographic upleg, and that the inflection point of correction corresponds to a downward shift in the MY ratio.

Figure 7

Japan: Real Topix vs MY ratio



Source: Japan Statistics Bureau, United Nations, CLSA Asia-Pacific Markets

Figure 8

Japan regression of real Topix on MY ratio

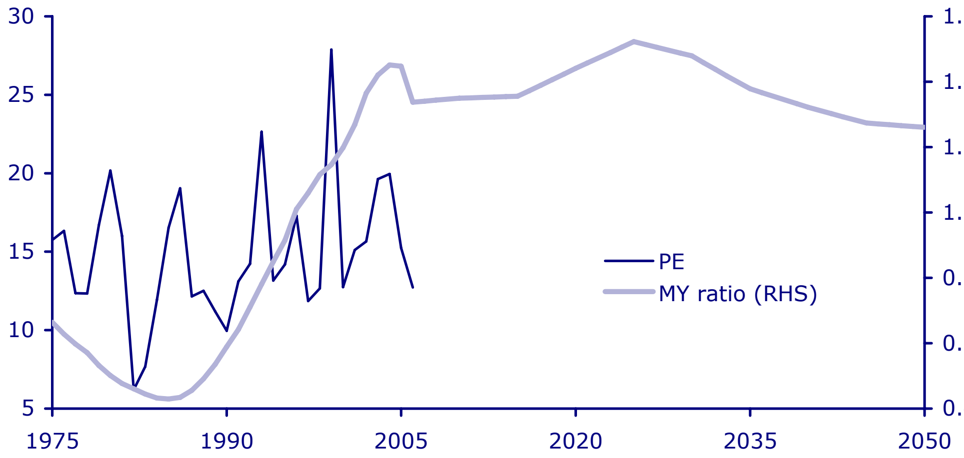
Constant	(1,323)
Coefficient	2,667
Adj R-square (%)	69.1
ADF t-stat	(3.40)
No. of Sample	58

Source: CLSA Asia-Pacific Markets

This finding is all the more important as Japan's market was acting independently of US market direction for much of the time. This is not a case of a common driver impacting two highly correlated markets. The linkages between demographics and each of the respective markets are independent. This provides all the more evidence that this MY ratio of a boomer cycle drives markets on its own. As local investors search for return in their middle years, this action alone has a strong influence on markets, all from the most domestic of sources.

When it comes to the linkage between the MY ratio and market price-to-earnings ratios in Asia, the effects are graphically less dramatic, although this is largely a reflection of our relatively short time frame compared to the volatility of the measure. If we look at a short enough stretch of the US measure we see a similar chart pattern. To best quantify any relationship we revert back to a regression analysis, which methodically measures the exact strength of the relationship. Here we see that the relationship is statistically quite strong, although in the case of Hong Kong, for example, the explanatory power of the relationship drops to about 7%. The MY ratio is important for forecasting trending shifts in level, not the exact valuation multiple on any given day.

Figure 9
Hong Kong: PE ratio vs MY ratio



Source: HK Census & Statistics Department, Bloomberg, CLSA Asia-Pacific Markets

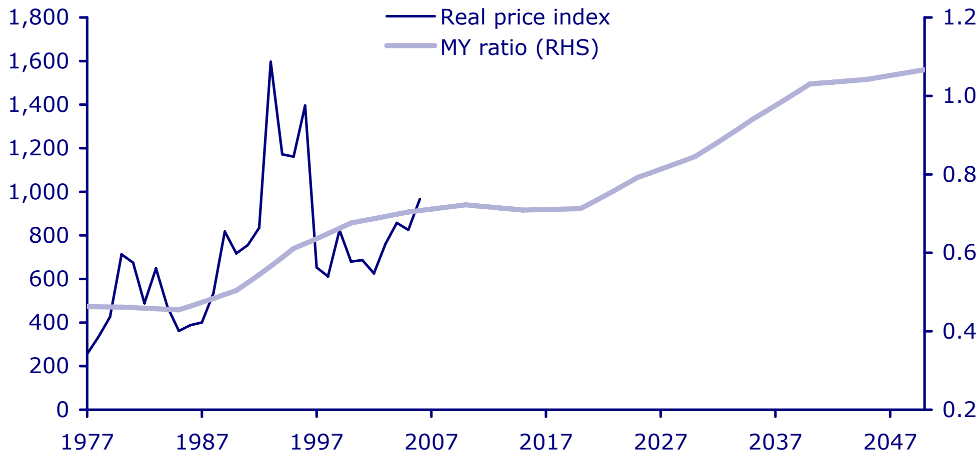
Figure 10
Hong Kong regression of PE ratio on MY ratio

Constant	11.8
Coefficient	3.8
Adj R-square (%)	7.0
ADF t-stat	(5.36)
No. of Samples	32

Source: CLSA Asia-Pacific Markets

In other Asian markets, a lack of data makes things more difficult to measure, but the evidence there certainly offers support to the link between demographics and markets. Malaysia goes back to as far as 1977. While the crisis through the late 1980s showed a long-term deviation from the trend, the indices indicate what could optimistically be termed as a tendency to bounce around the MY ratio. A look at Korea also shows one sharp peak as the index separated from the MY ratio and eventually returned to trade around it. With data from only 1980, this is enough to suggest that the trend remains true here.

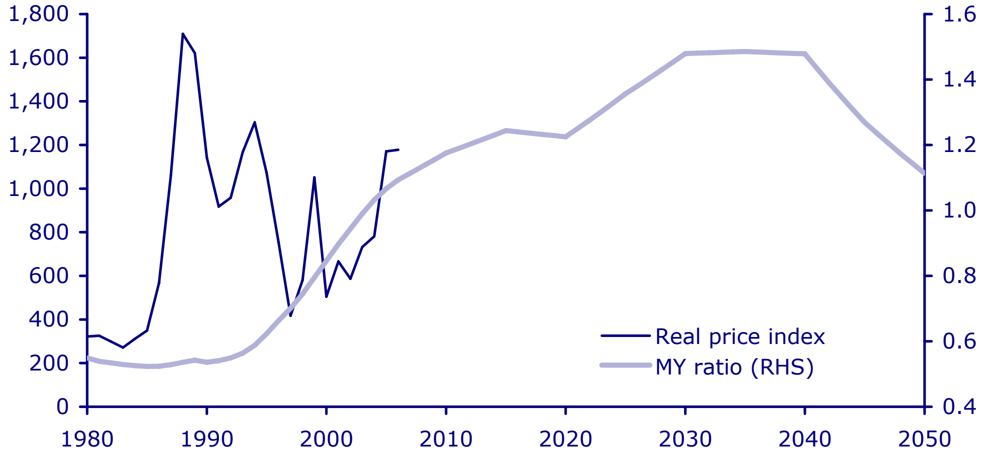
Figure 11
Malaysia: Real KLCI vs MY ratio



Source: United Nations, CLSA Asia-Pacific Markets

Figure 12

Korea: Real KOSPI vs MY ratio



Source: CEIC, United Nations, CLSA Asia-Pacific Markets

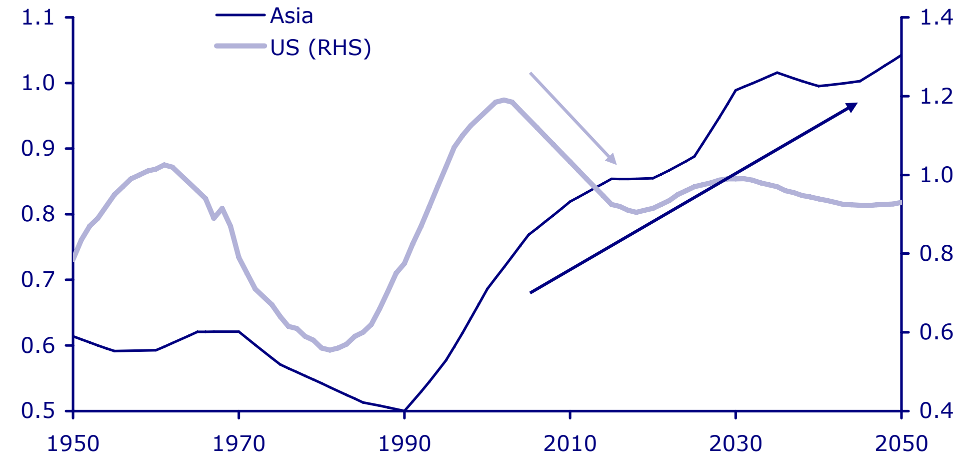
While the historical data is not as readily available for most of Asia, the evidence there also supports the findings in the US that the demographic "middle-aged bulge" helps drive equity market levels and valuations through their own changes in investment demand. Coupled with the commonsense view that a temporary boom in population will impact markets, there is a good reason to expect that this significant long-term driver will play a major role in market direction going forward. So what does all of this tell us about Asian markets in the near future?

Going forward

There is one very important and simple – arguably simplistic – finding from looking at the population demographic charts. Despite its simplicity, it has strong implications for global markets. Going forward, Asia's MY ratio is set to rise while the same fraction in the US has peaked. This suggests that demographics are set to drive Asian markets higher, all while US markets suffer.

Figure 13

MY ratio: Asia vs US



Source: *Demography and the long-run predictability of the stock market*, United Nations, CLSA Asia-Pacific Markets

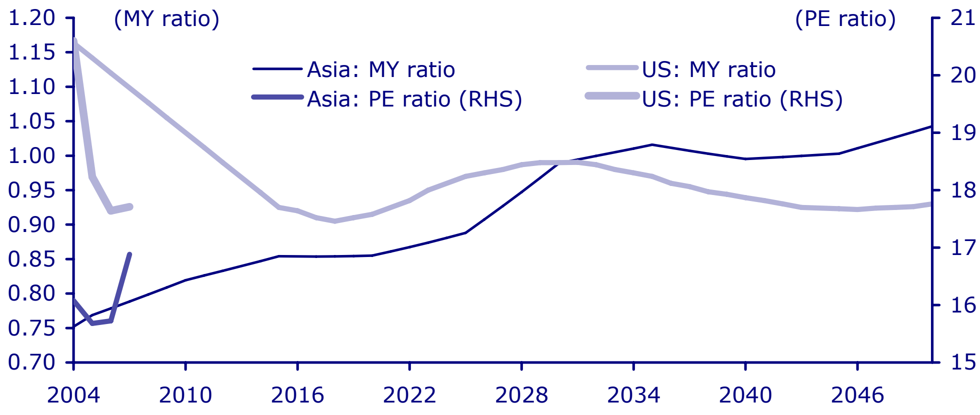
That of course is a broad-base statement and should take into consideration several caveats, specifically: the fact that this is more of an indication of level than of immediate change, that it is one of several factors which push markets, and that this is a long-term driver.

Still, for any CIO or other asset allocators looking at an Asian allotment, this demographic drive to market valuations and levels is a key component of what a particular region has to offer. Coupled with the important fundamental drivers of Asia's Billion Boomers driving earnings and intra-regional purchases, demographics show Asia beginning the next leg of a steady uptrend as the US is coming off of its peak to fall back to a long period of sideways markets.

Certainly, in the two years since the original report came out, markets and valuations are pushing in this direction. While it is still early in this long-running cycle, Asian valuations are climbing in tandem with the MY influence while PE ratios in US markets fall.

Figure 14

Asia vs US



Source: CLSA Asia-Pacific Markets

Where might this valuation shift push markets? Ignoring the heady prospects for earnings growth in Asia and looking solely at the valuation leverage implied by a burgeoning boomer cohort, Asia still looks set for strong growth in the coming years. Looking at the forecast real rates of price return from the original report - which ignores Asia's chunky dividend offerings - several markets have already pushed through their forecast levels. Adjusting for the subsequent earnings growth and looking forward from here, we see notable further upside due solely to multiple expansion.

Figure 15

Estimated real price index

	Real current level	Index forecast		
		2010	2015	2020
US	770	630	530	520
MSCI Asia ex-Japan	463	550	600	660
Hong Kong	24,344	28,740	28,890	31,030
India	12,272	15,240	16,420	17,700
Indonesia	1,329	1,460	1,670	1,820
Japan	1,803	2,220	2,910	3,030
Korea	1,607	1,760	1,870	1,840
Malaysia	1,222	1,440	1,420	1,430
Philippines	2,691	2,850	3,150	3,720
Singapore	3,463	3,130	2,260	1,780
Thailand	725	1,760	1,810	1,960
Taiwan	9,104	10,660	10,920	11,670

Source: CLSA Asia-Pacific Markets

Looking forward, it is also useful to observe on-the-ground evidence as to how this is already playing out. Are domestic funds starting to see the interest and bulge from the growing boomers' demographic? Our research teams in Seoul, Taipei and Tokyo have hit the streets to interview investors and market professionals to gauge the impact first hand. Read on to hear the boomers in action.

Korea: Practitioners' view - Banks and brokers

A financial house's perspective

To get a sense of how baby boomers are showing up on the radar of the banks we spoke to a senior individual in the product development group at one of Korea's larger financial groups.

An increasingly important theme for CLSA research is the impact of demographics on the demand for investment products and the implications this has for markets. How important is this to the thinking at your firm from a product planning perspective? Have you been developing any products for the 'soon-to-retire' segment?

We have completed some research on this topic. However, it is early days in this shift. As a starting point we have developed a product called the "Senior Plan". This product is primarily a deposit product in keeping with the risk profile of our older customers. Essentially upon building sufficient balances in their deposit accounts we provide options around free health checkups and insurance.

Overall we are aware of the increasing need to develop products in this space over time. However, outside of the Senior Plan I would not suggest we have specific retirement segment offerings. In terms of understanding what we can learn and apply from developed countries, we are trying to benchmark ourselves against product and service offerings in Japan and the US.

A key consideration for Korea however is regulatory constraints. Although we are confident that we have many product options for this segment that can be further developed, there are still quite a number of regulation hurdles between us and our target customer experience. For example, the regulations related to bancassurance restrict the insurance products a bank is able to sell.

Figure 16

Korean bancassurance deregulation timeframe

Phase	Date	Change
1st phase	Aug 2003	Long-term savings and casualty products
2nd phase	Apr 2005	Pure-protection products (No maturity refund)
3rd phase	Oct 2006	Protection products (with maturity refund)
4th phase	Apr 2008	Auto and all long-term protection products

Source: CLSA Asia-Pacific Markets, KIDI

As such, for a move to better products and services to gain momentum, regulations need to be eased. The government and regulators recognise this. When the consolidation act passes in 2009, we will have more room to innovate not just in terms of the range of products we can sell, but also how we offer them. Over time our offerings will be based solely on the customers needs rather than on what we are allowed to supply within the regulatory framework.

Can you give us some examples of products that utilise life-cycle concepts in the design or marketing?

Yes, we have developed a number of products that target different age groups. Examples include the Children's Fund (deposit savings accounts), the Worker's Plan (work-place oriented savings accounts), the Lady Plan (savings accounts targeted at housewives) and the Senior Plan mentioned earlier.

Could you tell us more about this Senior Plan?

As mentioned, we tie free health checkups and other benefits to deposit accounts when an older customer has an account that meets various balance targets. Looking at the mutual funds, we are yet to develop specific funds which target seniors. There are still regulation issues that make that difficult from a marketing perspective today, for example, we are prohibited from linking the pricing and benefits for funds with deposit products. At this stage we are still in the realms of special interest rates and waivers of transaction fees for priority accounts.

Because we are not allowed to tie the benefits of a higher risk product with those of existing deposit products it limits our current marketing flexibility. Once the capital integration law passes we will be able to sell bundled products.

Korea is often cited as the fastest aging society in the world. Are you seeing any change in demand patterns as a result of this trend?

I am not convinced there is much evidence of that. Although people in general feel a need to have these kinds of products, our research has been unable to isolate a specific demand for, or perhaps more importantly a concentration of demand around, a specific product. To be honest the results of our analysis were quite disappointing. We believe this is because customers do not appear to know exactly what they want or need after they retire.

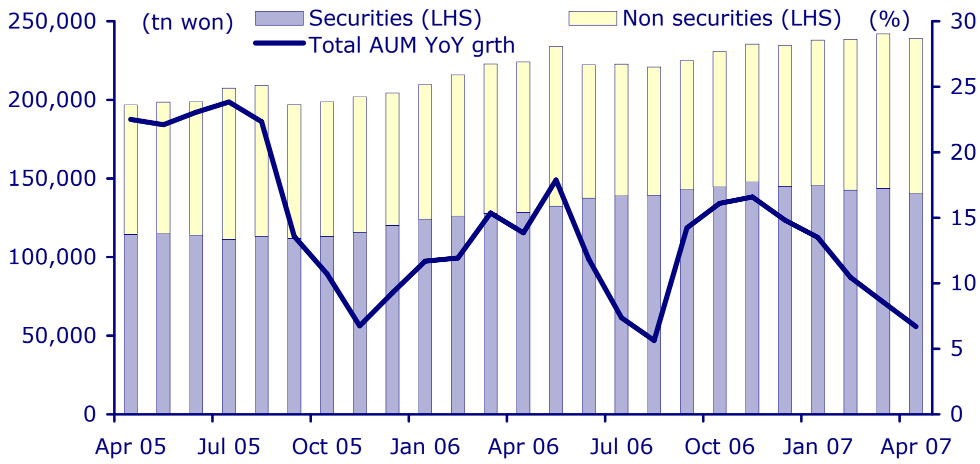
That's an interesting conclusion, in that context, why the increase in the popularity of mutual funds in Korea?

We believe this was actually more a function of successful marketing and the relative risk reward profile for stocks versus other asset classes than as a result of demographics shifts. In early 2004 customers were not satisfied with the interest they could earn from banks. Mutual funds emerged as the obvious alternative.

CLSA would suggest that the demographic trends could well be the drivers behind the search for a more attractive risk-reward profile. Regardless, it is clear that mutual funds have become a growth industry in conjunction with the climbing MY ratio.

Figure 17

Monthly balances of total mutual fund AUM



Source: CLSA Asia-Pacific Markets, Asset Management Association of Korea

An asset manager's perspective

An interview with a senior manager from the retail division of one of Korea's largest and most innovative mutual-fund companies.

CLSA research indicates that as the average age of a population rises, the demand for retirement-savings products - particularly equities - increases. Is the "soon-to-retire" market an important demographic for your business?

In terms of the ratio between people who are looking to retire and people who plan to continue their employment for some time, [the MY generation] market is bigger for us today. Most people seem to purchase funds to grow their assets rather than to prepare for their retirement. In fact, in the past, retirement age was pretty much fixed. However, these days, it is quite hard to define what age group falls into the so called "soon to retire" age.

Korean people have been looking for places to invest their assets and have found profitable investment tools such as instalment-fund products. Buying funds is starting to become an essential part of life planning for most Koreans. In order to meet these newly-created demands Korean financial institutions are in the process of setting up more sophisticated systems and products.

Korea is one of the fastest ageing populations in the world. Do you see any evidence that this is impacting the demand for your products? If so, can you provide examples?

We are definitely witnessing stronger demand and we have long-term (10-20 year) instalment funds and various pension funds. However, I do not think certain age groups triggered this increase in demand. With limited investment sources in Korea, Koreans started to perceive the stock market as one of the most attractive investment tools available to them in terms of expected returns and risks.

Figure 18
Customers by age group

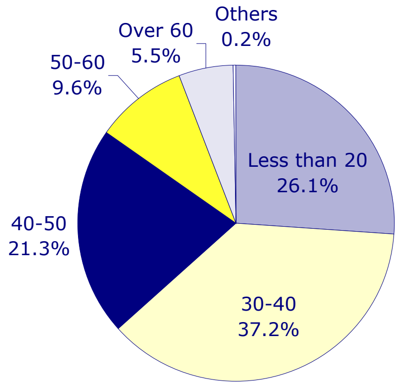
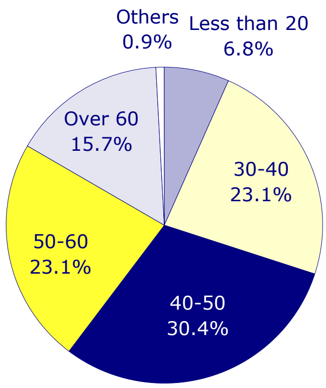


Figure 19
Customers' asset by age group



Source: CLSA Asia-Pacific Markets, company data

Should we expect Koreans to increasingly shift out of property into other asset classes?

Yes. It is true that Koreans are Overweight property. An NSO study shows Koreans put 80% of their asset into real estates. However with increases in indirect property funds we can observe this trend has started to change. Also the government's deregulation on offshore investments and in particular funds and properties will also contribute to diversifying investment sources.

Figure 20
Korean household asset by age group

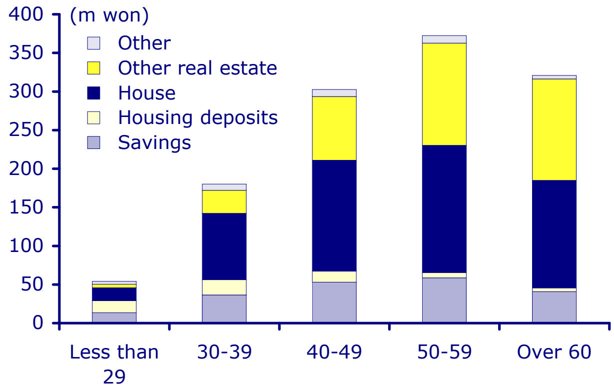


Figure 21
Korean household liabilities by age group

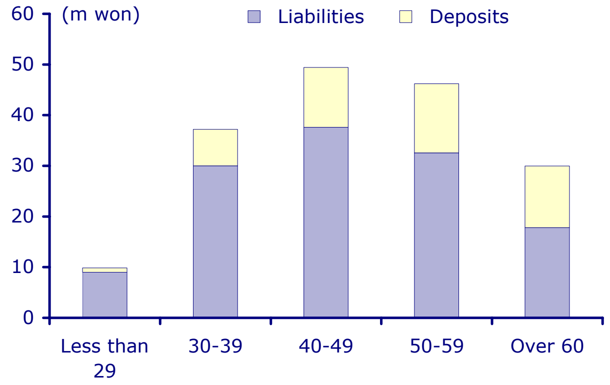


Figure 22
Korean household asset by income quintile

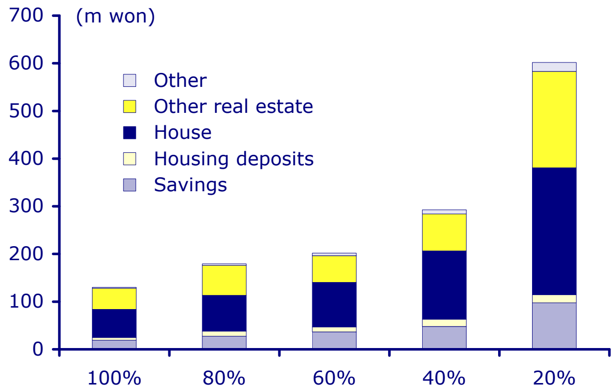
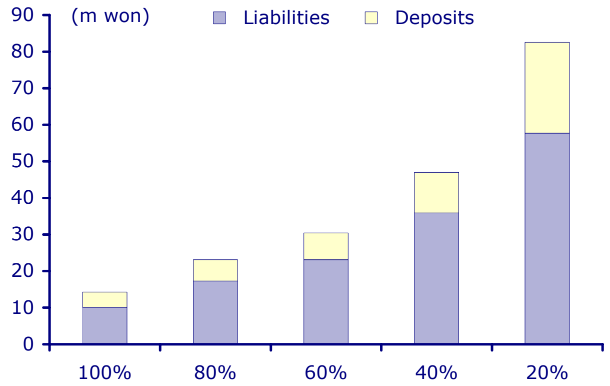


Figure 23
Korean household liabilities by income quintile



Source: CLSA Asia-Pacific Markets

Could you give us some examples, are your fund managers developing new types of funds to target investors planning for retirement?

Tailoring the offering to older clients is more about picking the right mix of standardised products than focusing on specialised retirement products. Where we are looking to fit products to the customers' life cycle, it is predominantly in the risk structure. Higher-risk funds tend to have greater equity weightings. For example, when a client is young, he or she is more likely to have a relatively small asset base and a longer investment horizon, which suggests young clients should take a more aggressive investment strategy and invest in instalment products. A customer's risk appetite is one of the biggest factors we consider when it comes to providing the right product.

What about the national and corporate pensions – Are they a threat or an opportunity for your business and why?

We don't think the pensions impose a major threat. First, even if the law changes, the amount of money each person will pay into these pensions will not dramatically increase the typically monthly-savings balance. More importantly, these government initiatives generate awareness of the risks of not saving for retirement. With so many uncertainties around pension systems, people are looking for their own solutions. Second, our primary customers are people with accumulated assets who usually place a lump-sum amount of their asset into our funds. The new pensions are targeted at those without assets today.

Advertisements in action: Educating the market

A media review suggests that the marketing departments of the major financial players have without question recognised the value of an ageing society. Product providers are asking the obvious question: Are you prepared for retirement? The consistent line from the private sector looks to promote awareness of the need to plan for retirement (and probably a little fear). Alternatively the National Pension is pushing a WHAM (win the hearts and minds) campaign to address an emerging crisis of confidence.

Fear sells papers

The degree to which the typical Korean can fund retirement has become a topical subject that receives regular press attention. With the National pension currently expected to run out of funds at some point in the future, it is increasingly common to see reference to the dire state of the social safety net in newspapers.

To demonstrate the seriousness of both the problem and institutional inertia that is driving and increasing focus on self-funded retirement, the Minister for Health and Budget Planning recently resigned in protest regarding the inability of the national assembly to pass changes to the National Pension Act that would address this problem – not surprisingly in such ways that any combination of the proposed changes would mean costs and difficulty to those who will some day depend on the system, all of which raises the angst among the general population.

Figure 24

The Minister for Health and Budget Planning quits as the National Assembly fails to pass a pension reform bill

Figure 25

A news paper article suggests required savings for retirement by current age group and target lifestyle

Source: CLSA Asia-Pacific Markets, The Pusan Ilbo

National Pension Fund - Headed for insolvency

The cause of all the commotion, the existing national pension plan, is a defined-benefit scheme, primarily providing income protection against age, disability and death. The scheme covers all residents and in simple terms offers retirees 60% of their pre-retirement income (originally 70%) when they have contributed for at least 20 years. The scheme includes a redistribution component whereby higher incomes are adjusted down and those who have paid in for less than 20 years receive fewer benefits.

However national pension system is often compared to a ticking bomb set to explode in 2047 when its low-premium and high-payout scheme will drain the budget. Put simply, the system is headed for insolvency.

The benefits offered cannot be funded by current reserves, contribution rates and yields given the projected proportionate decline in the employed population relative to the retired population. This is increasingly common knowledge and the subject of much media debate.

Under such a backdrop, it is not surprising that the National Pension Advertisements focus on instilling confidence in the system. The need for these conficence-instilling efforts is a strong sign as to exactly how little confidence the average Korean holds in the system's future.

Figure 26

The National Pension wants to win the hearts and minds

Source: CLSA Asia-Pacific Markets, press

Looking at the two advertisements above, the first on the left assures Koreans that the National Pension will provide for them when they are "old and exhausted". Alternatively the advertisement on the right is reaching out to college students in search of ideas for improving:

1) The NPC image

2) Services

3) The website, and

4) The contribution rates of the self employed

The product providers in the press

This environment of fear and uncertainty is not lost on the private sector. As one would expect, a scan of the advertising from the Mirae Asset Group sees insurance and corporate pensions the focus for the retirement planning offering. Looking at their advertisements we see evidence of three basic strategies:

1) Traditional products advertisements: selling the benefits of existing retirement saving products.

2) Awareness campaigns: highlighting the role of these products in securing a comfortable retirement for both the head of the family and dependents.

3) Contact campaigns: designed to establish the relationship such that Mirae can educate clients directly on the needs for and benefits of the products.

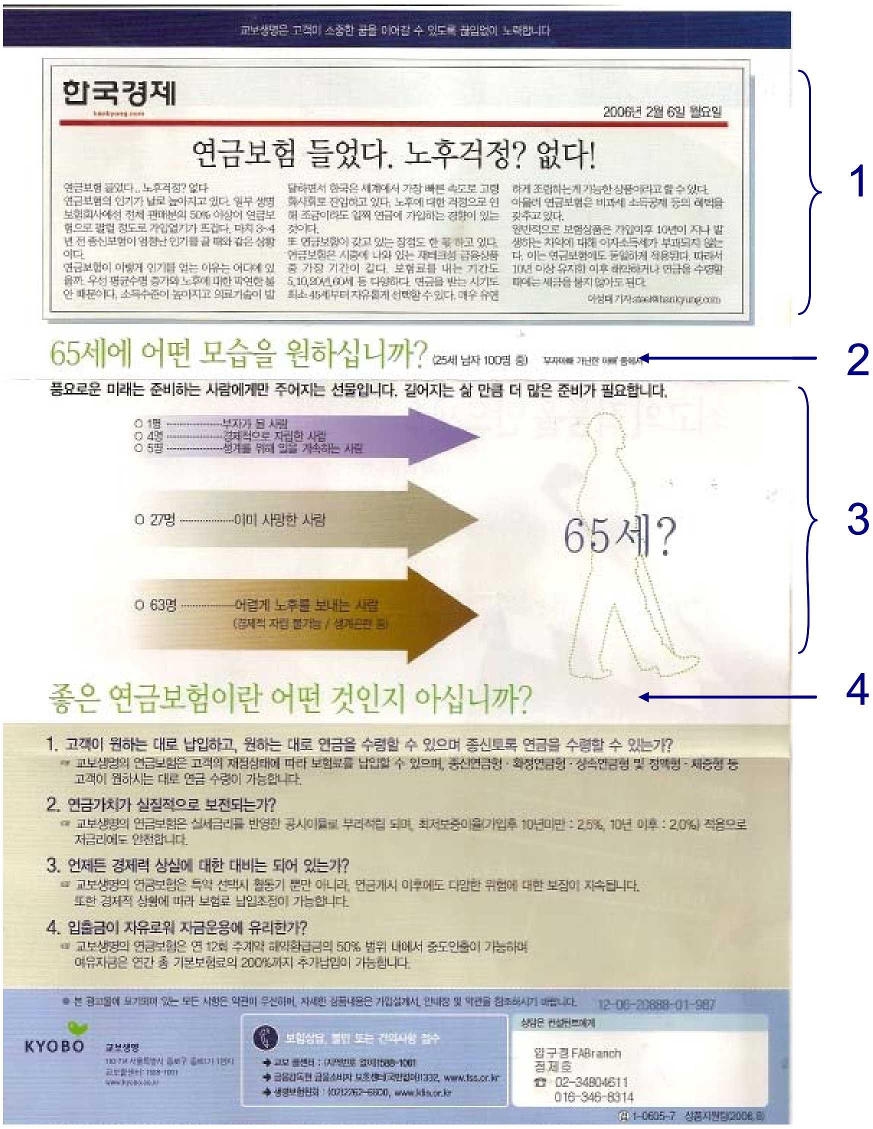
Figure 27
Mirae's advertisement on retirement products

Source: CLSA Asia-Pacific Markets

In Figure 27, we show three examples of Mirae Asset Group advertisements that address each strategy. The first is a pure product promotion highlighting the tax deductibility of contributions, attractive yield and flexibility of contribution methods. The second is simply a teaser highlighting the need for life insurance to protect the future of dependents. The final ad offer prizes for customers that record comments about their level of preparedness for retirement or complete quizzes about retirement issues – clearly a campaign aimed at both establishing a relationship and demonstrating a need for action.

Figure 28

Kyobo Life also driving from an awareness approach



1) Quoting the press in the advertisements

- ❑ Newspaper article discussing the dramatic increase in popularity of pension insurance products.
- ❑ For some life insurance companies such products make up 50% of total sales.
- ❑ Korea is one of the fastest aging societies, and pension insurance offers a unique mix of longer maturity, flexibility of payment, and tax deduction.

2) They ask:

- ❑ How do you picture yourself at age of 65? (Surveyed 100 25-year-old males)?

And suggest:

- ❑ An affluent retirement requires planning.
- ❑ Longer lifespans require greater retirement preparation.

3) Customer responded with:

- ❑ 1= They would be rich
- ❑ 4= Financially independent
- ❑ 5= Continue to work to support family
- ❑ 27=Already dead
- ❑ 63=Barely making living

4) They ask what is a good pension product?

- ❑ Flexible payment amount.
- ❑ Various options on how to payout the product.
- ❑ Preservation of value of pension.
- ❑ Preparation for any possible economic loss.

Source: CLSA Asia-Pacific Markets

The horse's mouth: Korean investors in action

To cross check the conclusions drawn by the companies we interviewed, we pulled apart the available local evidence. We draw three core conclusions:

1) Retirement concerns are the single most cited driver of increase savings.

2) Koreans are Overweight property

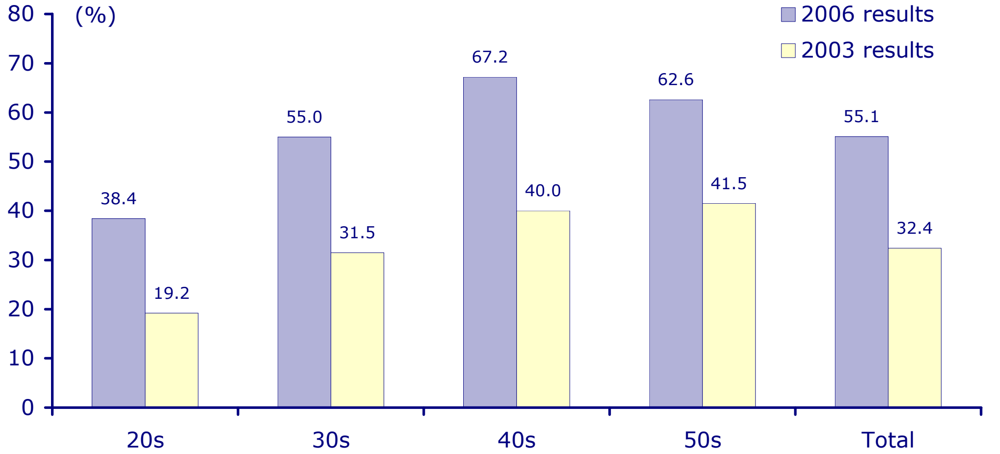
3) Advice services remain the greatest gap for the industry.

Koreans' retirement plans: survey evidence

The Korean Chamber of Commerce (KORCHAM) has conducted a periodic survey on the retirement plans of workers in Seoul since 2003. The most recent survey shows a significant increase in percentage of workers that are preparing for retirement.

Figure 29

Percentage of employees preparing for retirement

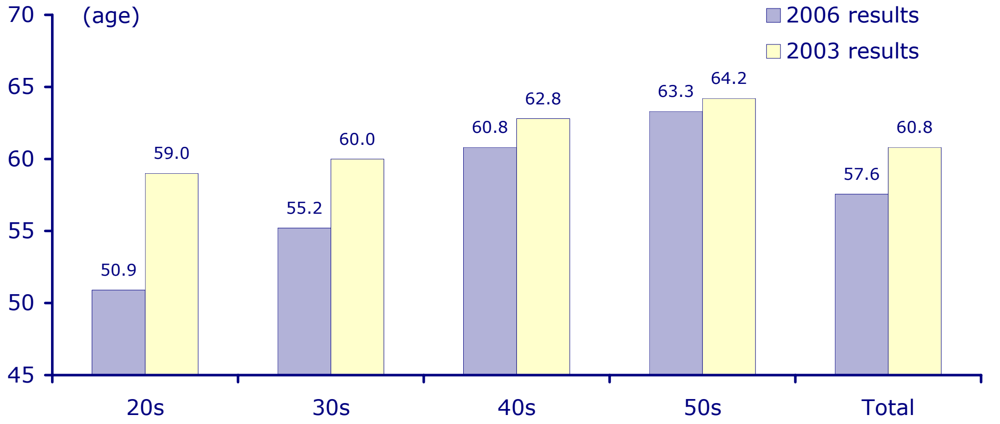


Source: Korean Chamber of Commerce, CLSA Asia-Pacific Markets

The results of the July 2006 survey found more than 55% of workers have been actively preparing for retirement, up from 32% in 2003. Interestingly, the most pronounced increases in concerns over retirement were observed in the younger groups. Koreans are also aspiring for earlier retirement. Workers in their 30s are indicating that they hope to retire around the age of 55.

Figure 30

Preferred age for retirement by different age groups



Source: Korean Chamber of Commerce, CLSA Asia-Pacific Markets

The increase in the target retirement date by age group is noteworthy. Younger generations look to be entering the work force with unrealistic and untested assumptions. Over time, experience, perhaps deeper consideration and most certainly reality will probably temper these views. Looking at the sharp decline in planned retirement ages in Korea for the youngest generations, we suspect the strong returns achieved by mutual funds in the past three years are contributing to an exacerbation of these unrealistic expectations.

Koreans in general are in need of reliable financial advice. Demand and products has moved quickly in Korea, whereas a knowledge-based work force will evolve slowly. Products are easy to replicate based on observation. However, the development of a qualified advisor network is people dependent, experience based, expensive and time consuming. Nonetheless, the clock continues ticking with the peak MY ratio set to continue rising until 2013.

Figure 31

MY ratio for Korea

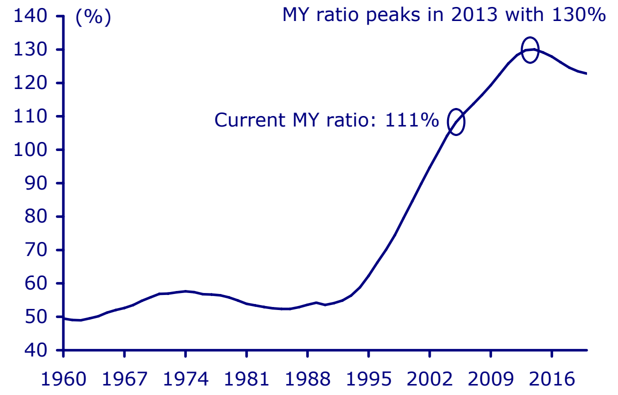
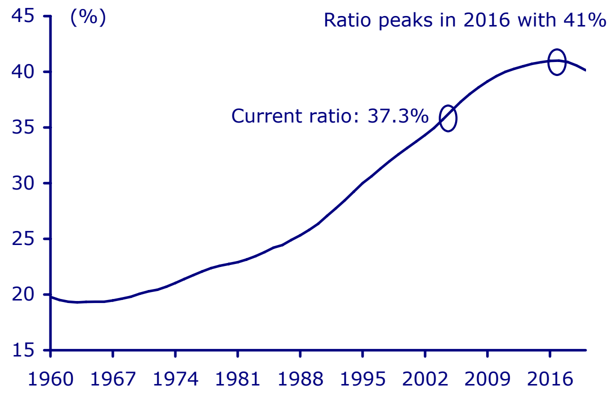


Figure 32

Percent of age 35-59 in total population

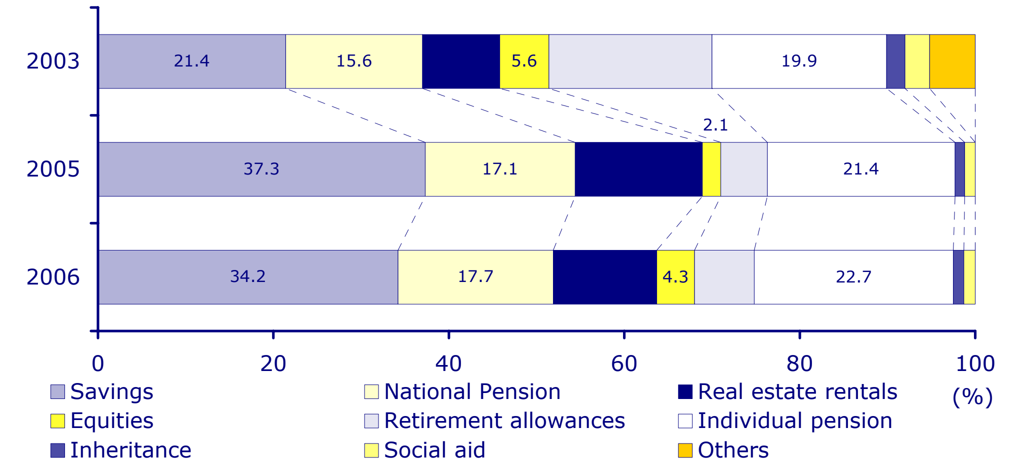


Source: NSO, CLSA Asia-Pacific Markets

Savings and public pensions remain the dominant means of expected retirement funding. At the margin, equities and individual pensions are growing at the expense of savings and rental income.

Figure 33

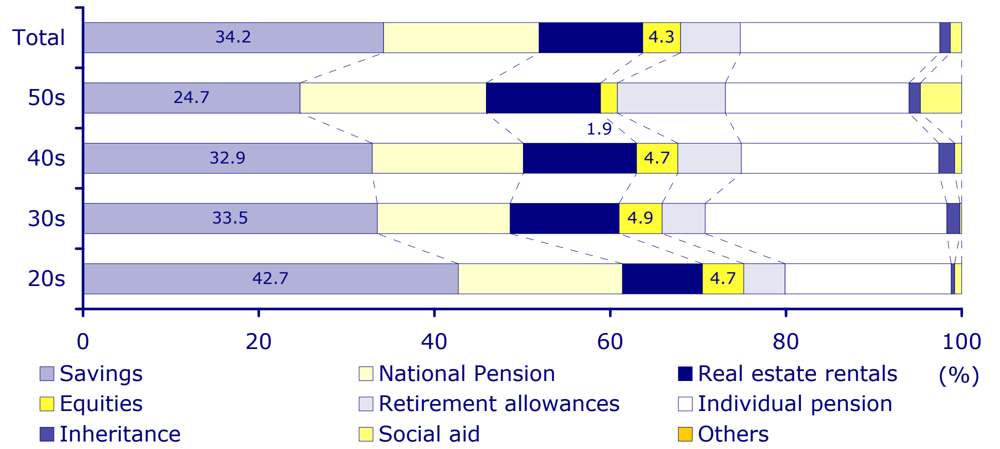
Preferred investment assets for retirement plans



Source: Korean Chamber of Commerce, CLSA Asia-Pacific Markets

From a demographic perspective, retirement-funding preferences look to be correlated with the logical progression of net assets through the life cycle. The prevalence of the savings and the national pension declines as alternate asset bases accrue.

Figure 34
Preferred assets for retirement plans by age



Source: Korean Chamber of Commerce, CLSA Asia-Pacific Markets

However, looking at alternative data from Hankook research that strips out public and employer-funded vehicles and focuses on private savings, the equities appetite rises with age as one would expect. Consistent with all our other sources, real estate remains the dominant option across all age groups.

Figure 35
Preferred investment portfolio

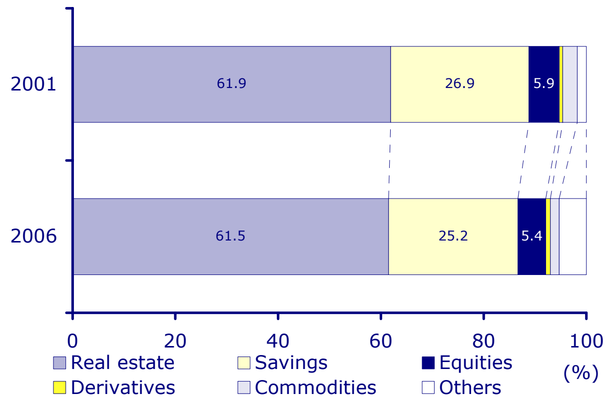
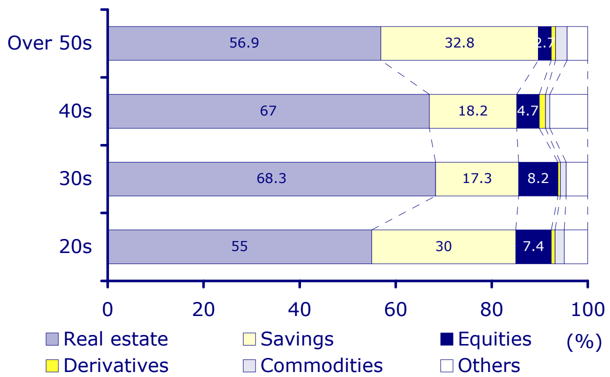


Figure 36
Preferred portfolio by age



Source: Hankook Research, CLSA Asia-Pacific Markets

The final consideration is portfolio preferences by income brackets. Not surprisingly, risk appetites rise with income such that savings for those earning greater than 3m won per month look to hold 17% of assets in cash and bonds versus 27% for those earning less than 2m won per month. Once again, real estate is the major beneficiary of the incremental demand at a 71% weighting for the higher income investors.

Figure 37
Preferred portfolio by education

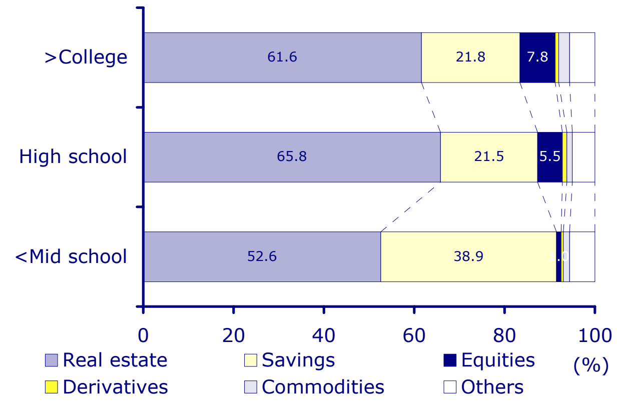
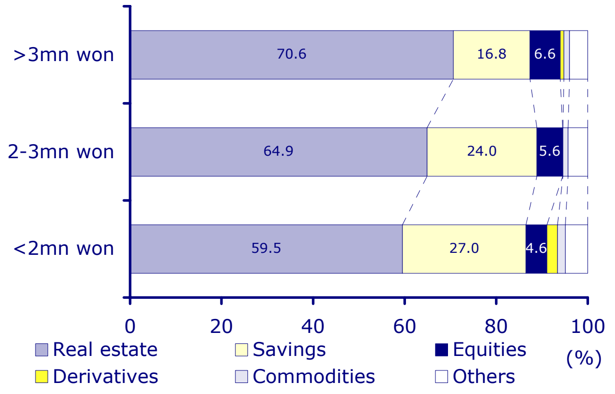


Figure 38
Preferred portfolio by income



Source: Hankook Research, CLSA Asia-Pacific Markets

On the ground case studies: Mr and Mrs Kim

As a final assessment of trends in the Korean retirement-savings industry we trolled the streets for some Mr and Mrs Kim experiences. While we acknowledge anecdotal evidence is a dangerous source from which to draw conviction, the two interviews below provide a neat contrast of the differing priorities and pressures of an upper-middle-class versus a working-class family.

Profile 1: Upper-middle-class end

Date of birth:	1955 (age of 52)
Offspring:	One son (age 25) and one daughter (age 24)
Marital status:	Married for 25 years
Education:	Graduate school
Current profession	Professor of medical school

Figure 39
What is your biggest financial concern?

a. Educating children	
b. Purchasing a house	
c. Medical expenses	
d. Everyday living expenses	
e. Retirement planning	√
f. Others:	

Source: CLSA Asia-Pacific Markets

We recently learned that our national pension on its own would not be sufficient to meet our financial needs after retirement. Right now we are trying to establish the best way to prepare for retirement.

Figure 40
How is your portfolio structured and how is that changing?

a. Real estate	50
b. Savings	25
c. Equities/mutual funds	25
d. Derivatives	
e. Others	

Source: CLSA Asia-Pacific Markets

Due to increased tax burdens and illiquidity, we recently sold off one property and invested into mutual funds, reducing property weightings from 70% to 50%. We initially put most of our fund investments into emerging markets including Korea. However, we recently switched a portion into advanced-market funds to lower the risks, based on advice of our trusted private banker at Hana.

Retirement plans

Have you been preparing for retirement? If so, since when?

Yes, about 10 years ago

CLSA note: Around the start of the MY ratio's M cohort.

At what age do you plan to retire?

Professors have a guaranteed position up to the age of 65 and I would very much like to work longer if health permits. Even if it's a temporary work at local clinic, I don't really mind working there.

Have you ever calculated how much you need for retirement?

Roughly yes. We recently considered the benefits that the national-pension plan currently offers and realised it would not provide us enough income. As a result, we started looking more actively for other means to fully prepare for our retirement.

Figure 41

Could you rank for us your preferred means of preparing for retirement?	
a. Savings	
b. National pension	
c. Real estate rentals	
d. Equities/mutual funds	1
e. Retirement allowances	3
f. Individual pension	2
g. Inheritance	
h. Social aid	
i. Others	

Source: CLSA Asia-Pacific Markets

We have subscribed to a number of individual pension plans for the past 10 years, yet I think it's only fair to say that we are currently relying on mutual funds for retirement.

Figure 42

When and where was the last time you had any financial advisory services from a professional financial institution?	
a. Banks (Hana Financial)	√
b. Brokers	
c. Insurers	
d. Others	

Source: CLSA Asia-Pacific Markets

Late last year, we found out that we needed a professional advisor to examine our current financial status and investment plans. We chose Hana Financial as our private banker after reviewing the options through internet surfing. We didn't bother looking into other financial institutions as we have a 20-year relationship with Hana, which is widely recognised for its strong private banking business.

Did you find the services satisfactory? Why and why not?

The service we got was more than satisfactory. We were advised to make some changes to our portfolio and so we did. The advisor gave us a monthly report, both in writing and on the phone, on investment results and notified us of any extraordinary risks that came up so that we could make timely investment decisions. He had a contact of legal and tax professionals on hand and even sent some cakes and performance tickets for our birthday . . . all of this free of commission!

Did you make any financial decision based on the advice? What was the result?

We were advised to reduce our weighting in illiquid property assets and increase our risk profile through mutual funds. We are basically happy with the changes we made. Before then, we never thought of mutual funds as investment assets and we intend to further increase our equities or mutual-funds weightings when we build up excess cash. Although we do not have a target yield for mutual funds, we will remain satisfied as long as the return exceeds what we can achieve at a bank. Even if we see the property market revitalising, we would be hesitant to return to that market as the tax burden has made it all the more difficult to achieve good yields.

Profile 2: Working class

Year of birth:	1960 (age of 47)
Offspring:	One daughter, aged 16
Marital status:	Single mother, divorced for seven years
Education:	Graduate school
Current profession:	Temporary college instructor

Figure 43

What is your biggest financial concern?	
a. Educating children	
b. Purchasing a house	
c. Medical expenses	
d. Everyday living expenses	
e. Retirement planning	√
f. Others:	

Source: CLSA Asia-Pacific Markets

As a temporary college instructor I cannot earn a stable monthly income, all of the above are of a concern to me. However, I am really concerned about my life after retirement as I know I have a limited shelf life in the workplace.

Figure 44

How is your portfolio structured and how is that changing?	
a. Real estate	90
b. Savings	8
c. Equities/mutual funds	2
d. Derivatives	
e. Others	

Source: CLSA Asia-Pacific Markets

I own a house in a nice area and that's pretty much all I have. Due to the rise in property prices, real-estate weightings have increased to 90%. Of course the rise in property tax is giving me a great headache, but I do not intend to sell this off any time soon. My savings and equity investments - including mutual funds - have been relatively stable to date.

Retirement plans

Have you been preparing for retirement? If so, since when?

Yes, I started saving for retirement about two years ago.

CLSA note: Investment began in the middle of the MY M cohort.

At what age do you plan to retire?

I hope to work as long as I can, but realistically there's not much chance for me to hold on to this job for many years. Competition is stiff, even for this low-paying, unstable job and I need to be prepared when the time comes.

Have you ever calculated how much you need for the retirement?

Not really.

Figure 45

How have you been/would you like to prepare for your retirement?	
a. Savings	√
b. National pension	√
c. Real estate rentals	
d. Equities/mutual funds	√
e. Retirement allowances	
f. Individual pension	√
g. Inheritance	
h. Social aid	
i. Others	

Source: CLSA Asia-Pacific Markets

Everyday I read in the papers that the national pension will be depleted in the coming 10 years or so. Looking at the size of my monthly contributions to the fund, I worry about my standard of living after retirement based on what the national pension can provide. This is the main reason why I have subscribed for individual pension plans, although the amount I contribute is not large.

When was the last time you had any financial advisory services from a professional financial institution?

None.

Figure 46

If not, from where do you want to get it?	
a. Banks	√
b. Brokers	
c. Insurers	
d. Others	

Source: CLSA Asia-Pacific Markets

I really don't have any experience in using a financial advisory service. To be honest, I can't really tell the difference in services that I'd get from banks, brokers or insurers. In case of future needs for financial advice, I'd probably visit banks for the location reasons.

Have you ever made any financial decision based on the advice? What was the result?

As discussed, I have never actually used advice, however if I were to invest extra cash, I would put together a very conservative portfolio because I do not want to take any risks given my poor monthly cashflows.

Views from the desk: Spending the CLSA bonus!

Finally we look at the anecdotal experience from one of our younger salesmen. The recent CLSA bonus round was of sufficient size for his mother to demand it be invested . . .What did Mrs Kim find, looking to invest her son's hard-earned won?

Parking the bonus

My mother did a "not-so-undercover" investigation into what funds were available to deploy her son's bonus into. Like all Korean mothers, she sees it as family wealth. Her findings were noticeably different from that of her husband's several months ago who happily deployed a sizable chunk of his savings into a Vietnam fund investing in unlisted companies with a lock-up of five years sold by KIH.

She visited Hana Bank, Woori Bank, Kookmin Bank, Samsung Securities, Mirae Asset Securities near Samsung-dong in Gangnam, Seoul, a neighbourhood with a lot of offices and premium apartments. Unlike her husband, who experienced the bank tellers and brokers pushing Chindia and Vietnam funds VERY strongly, she found a stronger push for "developed market" funds. Every bank or broker branch pushed at least one Japan fund to her, while others involved some European funds.

Despite her son's optimism and expectations, it appears domestic funds were still largely left out in what these tellers were throwing down the retail punters' throats, though various "Chaebol-group funds" were seemingly still in vogue.

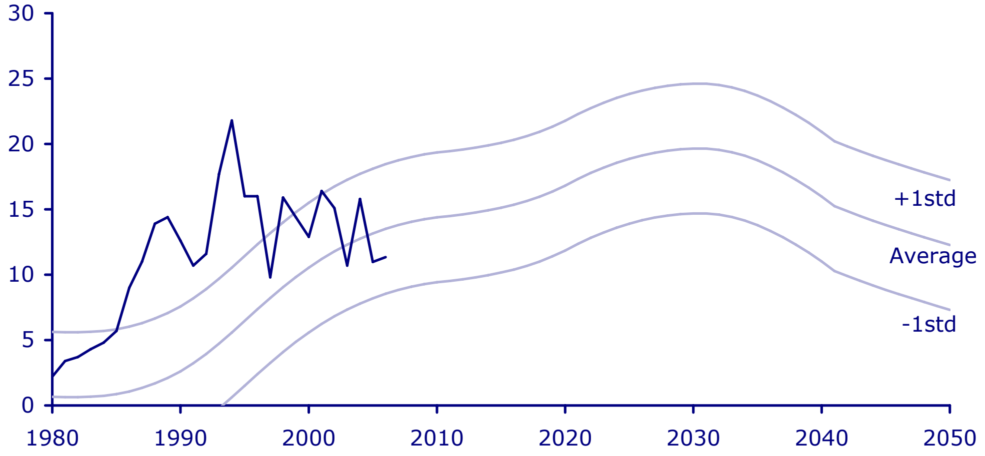
Samsung Securities . . . the most "convincing and thoughtful" in their advice, while the product she was most tempted by was a property fund managed by Macquarie - it "seemed safer and better than those Reits".

The one area not mentioned above that should be borne in mind is the expectation – now likely not to be met- that Korean overseas investment funds would qualify for tax exemption. Even allowing for this though, the digital nature of Korean investors suggests that the penchant for overseas investment remains intact.

What does this all means for Korea?

If the link between the MY ratio and Korea's valuations comes through, the typical Korean PE band should look something like Figure 47, showing Korea poised for plenty of multiple-driven upside.

Figure 47
Korea PE



Source: CLSA Asia-Pacific Markets

Look for domestic investment to continue to accelerate as the MY ratio moves higher, and look for domestic funds and retail-domestic investors to form a core of long-term, buy-and-hold accumulators in the Korean market. Evidence of increasing domestic investment interest is clear, from the fund managers, from targeted advertisements, and from the middle-aged cohort themselves. Middle-aged Korean investors will help to buy this market higher.

Taiwan: Practitioners' view - Insurers and fund managers

To get a sense of how baby boomers are showing up on the radar of the insurers, we spoke with the CEO of a major global insurer, which is a relatively new entrant to Taiwan.

Aviva Asia – Taiwan Branch

Aviva Asia comprises the Asian operations of Aviva, the largest life insurer in the United Kingdom and the fifth largest life insurer in the world. Aviva is the newest entrant in Taiwan's life insurance market. In April, the group and **First Financial** (2892 TT) signed an agreement under which they will set up a joint venture that is 51% owned by First and 49% Aviva. The First-Aviva joint-venture plans to sell life insurance, long-term savings and pension products exclusively to First's customers. We spoke to Christopher Knight, Aviva's chief executive officer in Taiwan.

Taiwan has a rapidly ageing population, low birth rate, together creating a very fast expanding market for retirement-related investment services, and obviously Aviva is involved with that on the insurance side. Do you have specific marketing or product plans that will target this?

We're in the process of getting regulatory approval for our joint venture . . . and it will be a few months until we get the license. However, First Bank is a very old bank here as you know, and its customer profile is typically older people, including couples nearer to retirement and also business owners, small business owners and so forth. In fact, retirement is a hugely important part of why we wanted to do business with them in the first place.

And a general point, from our perspective, it's more to do with distribution challenge than it is a product challenge. All the products that you possibly want just about are here already in Taiwan. It's a question about delivering them to people in a way which makes them want to buy them. And so we're very specifically working with First to make sure that we can package products in a way and train their people in a way that will allow them to take the time to sell a retirement product to their customers.

Is there a specific marketing plan or a specific type of product that you would use to target those people that are soon to retire?

Yes there is. We would certainly be looking at interest-sensitive annuity products, which is what they're currently selling to people. And we'd also look at structured note products and also variable annuity products.

I suppose in a sense that's all targeting things that are generating an income stream?

A lot of people when they're nearing to retirement don't actually need income per se. They may have different sources of income, they might be easing themselves into retirement, and so a lot of people at that age are buying structured note products in sort of five-ear terms, structured five to eight-year-term structured notes.

So is that then not looking for an income stream, but looking for something of a bullet at a specific time in the future?

Right. They've got excess capital, they don't need it. They want something that gives them some sort of floor in terms of minimum money back or something. And they're prepared to take a bit of a punt on the latest sort of investment trend if you like, to get them upside.

Your business hasn't ramped up yet, but how has the introduction of the government's new pension plan – now almost two years ago –affected your marketing and product design plans?

I think it's probably raised awareness of retirement-planning needs. The new plan is obviously more relevant for people that are slightly further away from retirement than those that are right at retirement in the government plan. Of course it's about saving throughout your working life to get a pot of pension money at the end of your career, but it has raised awareness. And I think that's all it's done really . . . it's done very little for the market as a whole. I mean, it's not been a practical proposition for insurance companies to design and market pension products that comply with the regulations.

You wouldn't be making a product that is part of the plan, but would you design a product that is complementary to the plan?

I think we will look at things that are over and above, yes, that a customer, having satisfied the minimum requirements of the government scheme, whose awareness of retirement planning needs have been raised, would then want to go and buy some supplementary plan, yes, that's definitely what we would do. And we will also introduce plans that essentially provide somebody with a vehicle for getting into the habit of making regular retirement savings, but also having the flexibility to throw in extra money into their retirement pot, if you like, as and when they get it. For example, when they have a bonus or some other investment matures.

Right. So I guess the ideal customer for you is someone who puts in NT$10,000 every month, and then at bonus time in January or February comes in and drops in another big bullet?

Yes . . . that would be great and that's what people should be doing really.

In terms of investor preferences, say fixed income versus equity, dividend yield or interests and say growth and value, what do you see as the most popular type of product, or the type of instrument for the retirement market?

I think it depends on whether you're talking about people at or near retirement, or people a long way from retirement who are building up their savings.

I guess it is different parts of the same market. I think people who are near retirement are more persuaded usually by lower-risk investment strategies, and that's really what they need. You don't want somebody sort of late 50's, putting a large part of their retirement savings into some high risk-equity investment, because they could get unlucky, it might go down 25 percent and they've got no chance to recover that money, of working to recover that loss. So I think people at that age are more looking, as you say, at the sort of interest-sensitive product, such as those products which give absolute very, very firm floors to get their money back.

For people younger than that, it really does depend a lot on what people are presented with, so that whatever the sales person is looking to sell or whatever the company's looking to market, can have a big influence on what people would do. If people take the time or the sales channel takes the time to explain to customers what their needs are and what might happen in the next years, then I think they tend to go for more equity investments on a longer-term basis. And I think you'll see a lot of the companies, even some of the old professional companies now selling an awful lot more unit-linked policies than they used to, and typically speaking, those unit-linked polices are invested 60-70 percent in equities.

JPMorgan Asset Management

JPMorgan Asset Management and the heritage Jardine Fleming Asset Management was one of the earliest entrants in Taiwan's investment trust business in the 1980s. JPMorgan Asset Management has over US$1 trillion in assets under management globally and over US$4.2 billion in assets under management in Taiwan. We spoke to Judy Shih, managing director and head of marketing and communications, and Alex Pan, vice president and head of institutional business.

As Taiwan has a rapidly-aging population and there is a fast growing demand and market for retirement services, how has your company changed its marketing strategies and products to meet that market need? Do you have specific products or strategies targeted at that market?

Alex Pan: We are quite aware of the booming situation in the asset-management industry in Taiwan. [It] is grounded on a very strong rally in global equity markets, so it creates a situation where the distributors only rely on revenue associated with transactions rather than the AUM they keep in their accounts. They just encourage transactions, and it is a very easy thing to do simply because when the client is making money they don't mind if you trade their accounts. I'm not saying we will have a crash in the near term, but we are close to a very critical point where we must think how about the end of the global-equity rally.

The first thing we must recognise is that the pension needs in Taiwan are something that has had a lot of discussion, but very few actions have been taken. If you walk into any financial institution in Taiwan . . . they will tell you they are [doing] wealth management. The research indicates that as compared with market timing or stock picking, asset allocation has the biggest impact on your portfolio performance, but if you go to their seminars they are talking about market timing all the time.

So we are trying to transform our strategy in a way that on the one hand we can try to ride the equity rally and on the other hand try to educate our investors about the importance of asset allocation to meet their pension needs. Some of this strategy has been implemented by our general marketing.

Judy Shih: I think to be frank, pension needs will be more associated with insurance and not with mutual funds, but as a mutual fund company we offer products to the retail side. In the past . . . I think our clients are younger than our competitors', but we recognise there is a need for much older people . . . they always prefer very conservative products with monthly distributions. Historically, both as JF and JPMorgan, we have been mostly an equity player, so we don't have enough fixed-income products.

Equities are very volatile, but it is very easy to accumulate assets if you invest in longer term. So of course we keep promoting savings plan and we keep promoting [the idea that] people need to invest for at least three years . . . longer term is good for accumulating assets.

But for those who are 40 or 50, actually they prefer fixed-income products with monthly distributions. The market demand for offshore fixed-income products in Taiwan is huge. Clients are crazy about funds that provide stable return, particularly monthly distributions, which implies that these kinds of products meet clients' pension needs. They usually don't care about capital gain or loss as long as they can receive decent dividend every month.

We don't have any registered fixed-income products in the JPM group that provide monthly distributions now, but that is something we may address in the future. The second important thing is unit-linked insurance policies. This is a new business we are ready to explore starting from this year. This is managed by Alex.

Alex Pan: I think to explore the pension we will transform ourselves from a fund house led by face-to-face contact with the client telling them what to buy, to a fund house that serves the distributors . . . then the funds will be distributed by intermediaries such as banks or through other platforms such as unit-linked [insurance] policies . . .

You can tell from the data that unit-linked policies - which are actually a regular savings plan designed to meet the pension needs – have experienced tremendous growth in the past few years. Actually, 2006 was the first time total premiums (FYP) collected by life insurance companies declined, but the premiums for unit-linked products still showed healthy growth last year.

Figure 48
Taiwan life insurance industry – First year premiums

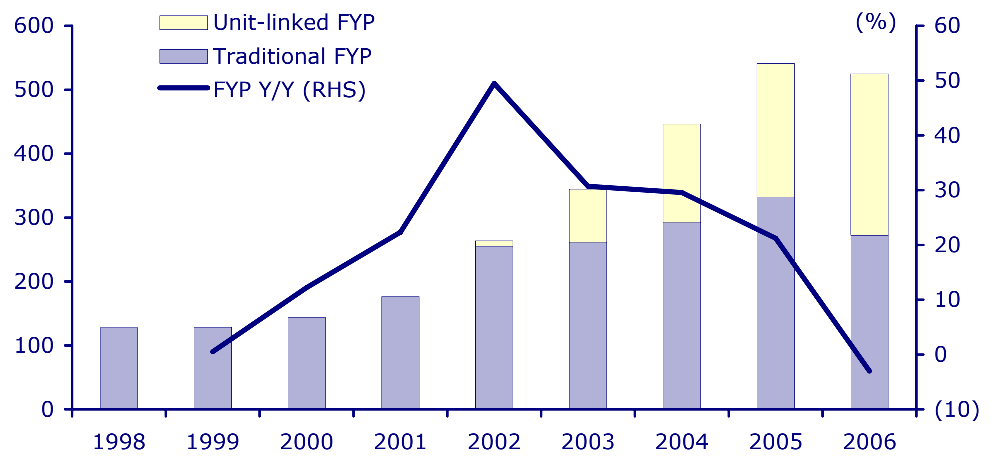
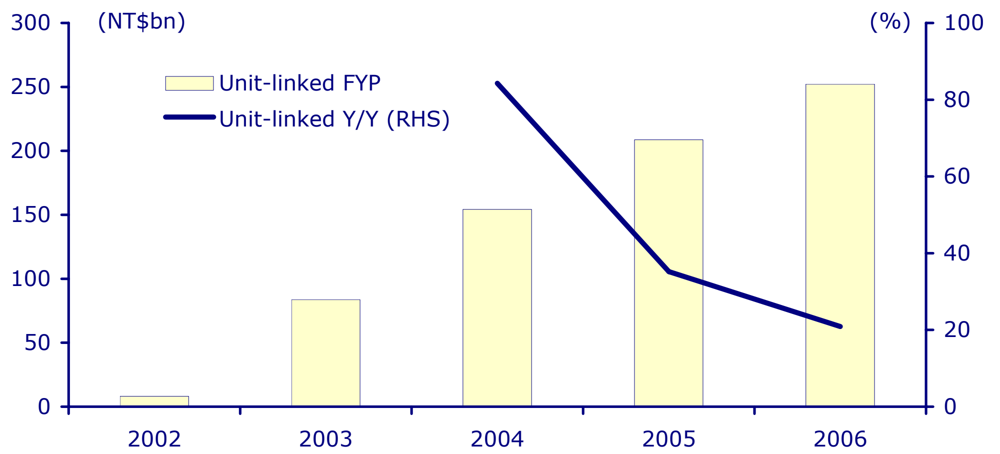


Figure 49
Taiwan life insurance industry – Unit-linked FYP



Source: LIA-ROC, Insurance Institute, CLSA Asia-Pacific Markets

So I think the financial institutions that can position themselves appropriately in investment linked policies to meet pension needs will have a strong advantage as far as pension management is concerned.

Judy Shih: We actually did a retail survey several months ago and when we asked "what are you doing to prepare for your pension?" unit-linked (insurance) was the most mentioned, so we think this business is very important. Since nobody mentioned mutual funds for their preparations, we need to offer products to link to insurance policies.

Two years ago the government introduced the new pension programme. Are there other changes being driven by the new pension programme? How has the market changed since then? Are investors becoming more interested in the pension-driven market?

Judy Shih: No I don't think this is . . . I think people in Taiwan are not really aware of the importance of pensions. There is a new policy, a new strategy . . . that's right, but as far as I know the money [in the government programme] is still kept in the banks, it's not invested. For all the investors, the money is deducted from their salary and they don't know where it goes.

For those who get a sense of the importance of investment, they actually do invest more as the market is still going up, but I don't think there are a lot of people who invest just because of the new policy from the government. I don't think so.

Shin Kong Financial

Shin Kong Financial is dominated by Shin Kong Life Insurance, the second-largest life insurer in Taiwan and one of the industry's earliest entrants in 1963. Shin Kong has acquired and merged together two banks in recent years, and the new Shin Kong Bank now serves as a significant new bancassurance and wealth management channel for Shin Kong. We spoke to Victor Hsu, Shin Kong Financial's first vice president.

As you know, Taiwan's population is ageing quite rapidly, and that is creating a fast-expanding market for retirement- related services. So I was wondering, do you have any specific marketing plans for new products that are targeting soon to retire investors? Maybe you have some examples.

Victor Hsu: In this market we have difficulty identifying the soon-to-retire group. In our client analysis most people buying policies with us still belong to the 30 to 40-year-old age group, so there's no significant difference, compared with some four to five years ago. There's no change that indicates the soon-to-retire group increased.

Do you see more demand for people who are thinking about retirement now, than you did maybe a few years ago?

Victor Hsu: Yes. Many people start to consider how to arrange their retirement funds, but when you look into the insurance business, you cannot tell that there is a big difference. We have had some small trend after the government started the new pension plan, and we have introduced some new products. One is interest sensitive annuities, where we did some modification to our old products.

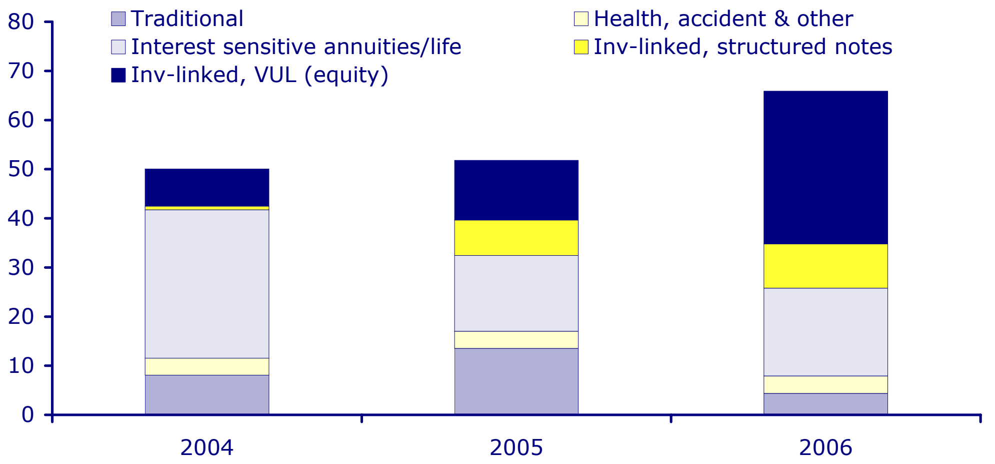
But because there are very strict limits on the new pension plan, it's hard for insurance companies to sell these kind of products into group [pension plans]. You might already know that. Insurance companies can manage this new pension plan for a company with over 200 employees, but only if it can get a consensus from the employees and get agreement from their labour union. So it's pretty difficult. Many life insurance companies can see it is almost impossible.

What about creating products targeted at people who feel that the government pension is too small – new products that might be an add-on to the government pension?

Victor Hsu: Yes, we tried to sell the interest-sensitive annuity as individual policy to individuals for accumulating their retirement funds. Interest sensitive annuity can be a good product for them to prepare for retirement. But product holders almost all focus on the crediting rate declared by the insurance companies. Right after the surrender-penalty period, they would surrender the policy.

Figure 50

Shin Kong Life – First year premiums (FYP)



Source: CLSA Asia-Pacific Markets

With low interest rates, are people moving away from fixed income and more to higher returns?

Victor Hsu: Yes. Nowadays policy holders, it seems, are just looking for investment return rather than a fixed income or a regular payment after they've retired. I think people still prefer the investment-linked product, especially those investments linked to overseas mutual funds with high equity growth.

Are there any other products or markets that are particularly popular?

Victor Hsu: Well, we have also tried to promote a kind of long-term care product, tried to educate the consumer that when age becomes higher, the need for disability income is important. We have tried to do that, but it is still in a very early stage.

Advertisements in action: Taiwan media push

Taiwan's business press writes endlessly on the topic of investing and investment products, but much of the content is promotional, "what's hot, what's not" type reporting. However, there are frequent reports on broader investment planning issues, many of which recently have been focused on saving for children's education expenses and meeting the gap between pensions and retirement needs.

Figure 51

The headline feature is targeted at mothers saving for their children's education


工商時報
全民財富總體檢
C2
月繳六千 攢下子女教育金
文／魏喬怡
賺出孩子的未來
購屋四大規畫原則
降低薪水超支風險
善用信用卡 懷孕檢查享折扣
爸媽優先投保壽險、醫療險
一成年收入繳保費，保額設定為年收入十倍，避免意外發生

Source: Commercial Times, CLSA Asia-Pacific Markets. Photography: Jerome Favre

Based on the amount of media coverage, we can assume that awareness of the pension gap is quite widespread. This view was confirmed anecdotally by the reaction we got to questions on this topic in focus groups we conducted with Gallup. Much of the media coverage focuses on the government's internal debate over still-undecided aspects of the pension system, and on the level of income replacement under various outcomes.

Figure 52

Economic Daily News - Workers get less under the Executive Yuan version of pension plan

經濟日報 綜合新聞 中華民國96年5月10日 星期四 A9

勞保年金政院版 勞工領得較少

年資40年勞工所得替代率44%，以最高投保薪資計算，活到85歲，將比勞委會版本少領52萬餘元。

行政院與勞委會勞保年金版本差異比較

提醒上市公司注意

證交所：法令明確 別作內線交易

綠委：勞保年金 趕明年實施

提前與國民年金搭配 勞委會將研議

蔡英文出馬協調

遺贈稅修法 暫緩

Source: Economic Daily News, CLSA Asia-Pacific Markets. Photography: Jerome Favre

The *Economic Daily News* also runs a fairly informative retirement planning page every Monday. The focus of the articles is educating the public on what is needed for even minimal retirement planning, and on how far the government pension scheme is likely to fall short. Short cartoons are used to communicate important information in an easy-to-digest format.

While this sort of investor education on big, big picture issues and goals is quite well addressed by the media, other areas of investor knowledge and education are sorely lacking. As an example, the chairman of one of the largest investment trusts in Taiwan recently noted that "[many] investors don't understand fixed income . . . they care about how much dividend they get, but they don't care about total return".

Figure 53

Economic Daily News – Retirement planning page


B2 退休金算盤 經濟日報

勞退金分期領 節稅妙招

全年領取額若低於67.6萬元可免稅；若選舊制，分期領須考慮公司未來營運狀況。

全球REITs近期展望

銀髮族買REITs 得避開美國

媽媽．愛家人別忘愛自己…

婦女同胞 善用年金醫療險

無條件保單 可能是意外險

Mr.Guru談理財

醫療防癌壽險 退休必備

退休族很哈…

寶來REITs 二度追加額度

退休須1,000萬 自己貼600萬

Figure 54

7 May

- The three articles in the centre talk about health, accident, and concern insurance. The top and bottom articles talk about the pension scheme and retirement savings.
- Bottom headline: To retire with NT$10 million one has to come up with NT$6 million on one’s own.
- The cartoon on the right explains that if one wants to retire with enough to live on for 30 years, one needs to save at least NT$9 million. The maths involved is a little suspect, but the message is clear.

Source: Economic Daily News, CLSA Asia-Pacific Markets. Photography: Jerome Favre

Figure 55

Economic Daily News – Retirement planning page


B2
退休金算盤
經濟日報
退休規劃 要建立核心資產
家庭基本資料
規劃調整前資產情形
理財目標
國泰全球基礎建設基金
基金停損停利 四大原則
1.定期定額停利不停損
2.依照類型設定損益點
3.依據風險承受度調整
4.看投資組合來做檢視
停損停利後…
贖回 可分批進行
勞保年金 晚退休較有利
50歲以下選年金制勞工 太早退休恐一段時間沒錢領
熬到70歲 所得替代率才有七成

Figure 56

14 May

- The articles at lower right "If one retires too early there could be a period with no retirement payments" and "You would have to work until you are 70 years old in order to achieve 70% income replacement through the pension system."
- The cartoon: "According to this, pensions total only NT$3-4m for the average person" "That's at least NT$6m less than the most basic NT$10m retirement requirement" "How do you make up the NT$6m gap?" "You need to depend on insurance and other investments, otherwise you need to delay retirement or get another job."

Source: Economic Daily News, CLSA Asia-Pacific Markets. Photography: Jerome Favre

Advertising by fund managers and financial companies often tends to focus on big concepts, brands or lifestyle-type advertising. Among the more creative and eye-catching advertisements we found that tapped into the themes of retirement and age demographics was a golf-themed ad from Paradigm Investment Trust. The simple gist is that Paradigm has fund products that meet the needs of investors at every stage of life.

Figure 57

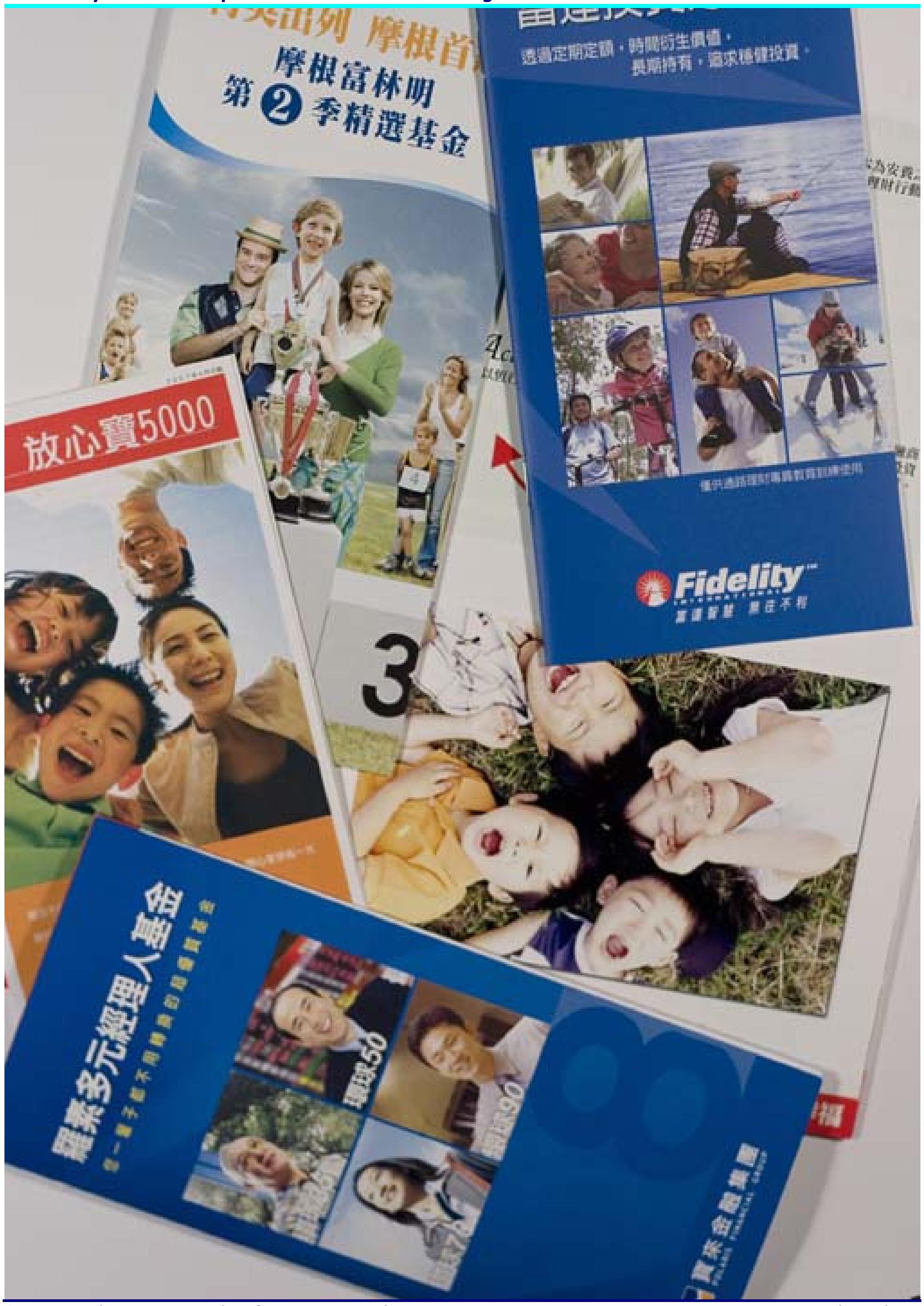
Paradigm Funds – Something for every stage in life

Source: Paradigm Funds, Business Weekly, CLSA Asia-Pacific Markets. Photography: Jerome Favre

Probably the most common device used in Taiwan financial advertising is the three generation family shot or the tugging-at-heartstrings parent and child shot. This is frequently paired with a variety of themes including education savings, death and health coverage, and a variety of "lifetime" themes.

Figure 58

The family shot is a staple of investment advertising



Source: Polaris, New York Life, JPMorgan Fleming Asset Management, Far Eastern International Bank, Russell. CLSA Asia-Pacific Markets. Photography: Jerome Favre.

Figure 59

New York Life – Tugging a the parental heartstrings

Source: CLSA Asia-Pacific Markets

The double-page ad below from ING is obviously targeted at middle-aged men looking to retire early to a life of relaxation in the sun. The "Lion Beer" and "Play Lion" magazine probably indicate a more narrow focus on single or divorced men, and probably would not have made it into advertisements in many Western markets.

Figure 60

ING Life – "Where do you look for an early and good retirement?"

Source: CLSA Asia-Pacific Markets

Personal interviews

We conducted two focus groups with Gallup in April to get an idea of what the man or woman in the street thinks about retirement planning. Among other things, we tried to get a sense of whether they think they have saved enough to meet their needs, what their priorities are, how they are investing, and how that might change in the coming 5-10 years.

There were two groups – one all men and one all women – and both were in Taipei. Below, we have excerpted the comments from two of the 17 participants, who we will call Mr. Lee and Mrs. Tsai (not their real names).

Subject 1: Mrs. Tsai

Mrs. Tsai is 47 years old and runs a small company with her husband. Their household income is about NT$150,000 per month, equivalent to about US$54,000 per year. She has two daughters in high school.

Question and answer:

Do you believe that the government's current pension scheme – including the various old and new plans – can satisfy your future post-retirement financial needs? Why? When you retire, would you prefer to take a lump-sum pension payment or monthly payments (from the government pension scheme)?

On this point I can't have too much of an opinion, because my husband and I have our own small company, so we are not working in any organisation, so we only have the labour insurance pension fund. As she said (one of the other focus group participants), it is not very much money, and not like the retirement funds for civil servants or others.

What are the most important future expenses you need to think about - taking into consideration all factors such as your current age, family situation and your parents (needs)?

Future expenses/priorities: Higher education (possibly overseas), possibly childrens' expenses before marriage, and living expenses in retirement.

I am now over 40 years old, and have two daughters in high school, also my parents do not need me to take on their expenses, because I only have my mother left and her own funds are enough for her use. About the children, because they are already in high school, in the future we may plan for the expenses for them to go overseas or stay in Taiwan to study. In addition to their schooling, we also need to think about our own food, clothing, and housing . . . entertainment, and every other type of expense. I hope we can maintain our current standard in the future.

As for the children, I hope in the future that they can take care of me, [but] because I feel that in today's society the money our children earn from work is not even enough to take care of themselves, I wonder whether they might need to live with me. Our childrens' education, including the potential cost of studying overseas, and our general household expenses.

At the going rates, a university graduate or even a masters or Phd graduate does not make enough – only a few tens of thousands per month. To put it simply, its not really enough for young people's needs, so I would like to say that when they are independent in the future, with the living expenses needed in Taipei, rental expenses . . . relative to what they earn it's just impossible. So I would like to say that in the future if my daughter has not yet married, perhaps she will live with me, and I won't accept any rent from her . . . so I may end up paying some of her expenses.

Based on the previous discussion about your future needs and expenses, what sort of investment plans have you made. For example, have you purchased real estate, deposits, stocks, funds, insurance, futures, bonds or other products, and why?

Investment products used: Health insurance, investment-linked insurance policies, foreign currency deposits, funds (mostly overseas), Taiwan stocks, and real estate.

My plan for medical is to buy insurance, health insurance, buy all the basics. Additionally, these past two years I've bought investment-linked insurance policies for my husband and daughters, just to invest in funds and insurance. I hope that now while they are still studying, I can pay the premiums, and then when they are independent they can pay the premiums themselves.

Otherwise, I have deposits, foreign currency deposits, stocks, funds – mostly overseas, more than ten [funds] from every region, Europe, North America, Latin America, Asia, Japan, bond funds, resources. Recently I've invested a bit in Taiwan stocks – in the past I only invested overseas – the results were a bit better. Lastly, in real estate I have a small, small investment.

Based on your current investment plan and the rate at which your assets are accruing, do you believe that this can satisfy your future expenses/needs for taking care of your parents in their old age, your children's university expenses, and your living expenses in retirement? Why?

I feel that the rate at which [our] wealth is accruing is not good enough, because I feel that the profits on current investments are still not that good. But if you think about retirement, for instance if you are 50 years old, the number of people who live to 70 or 80 is so high now. If I lived to 70 there would be 20 years, and if you take the yearly expenses for the two of us my husband and I . . . don't include the kids, when they grow up they will take care of themselves . . . take NT$100,000 per month in expenses for my husband and I, if I calculate based on today's financial ratios for two people one year is at least NT$1 million, ten years NT$10 million, twenty years NT$20 million just for the basics, and you can't have any losses in the meantime.

So if you look at the overall plan, if I want my assets to accrue at the rate that I want, I will have to work harder at it. For instance, if we take deposits, interest rates are so low, and you won't always make money in stocks, and profits on funds we need to look at the long-term. At my age, investment professionals should recommend stable [investments], with not too much high return, but personality has a part that is still very aggressive. For instance, I still invested in Latin America . . . one still has to judge an investment's risk. If the rate at which I grow my assets is not enough, then I'll have to wear less clothes and fast.

Figure 61

Mrs. Tsai – Self-reported asset mix

Asset class	Current weighting	10 years in the future	Notes
Real estate	60	30	Don't want to invest more in Taiwan real estate.
Deposits	15	15	Includes non-NT$ deposits.
Stocks	5	10	
Funds	10	30	Mostly overseas.
Insurance	10	15	Health and investment-linked

Source: Gallup (Taiwan), CLSA Asia-Pacific Markets

On real estate: My current weighting in real estate is very high, but I don't want to invest any more in Taiwan real estate.

On stocks: I believe the risk in Taiwan stocks is too high, so I have not invested very much. I believe Taiwan companies are not stable enough, very volatile, also have insider trading, and this can impact the shares, so I just want to have an appropriate exposure and that will be just fine.

On funds to 30% from 10%: Because they are easy to redeem [for cash].

In the table below, we recalculate the weightings based on financial assets only (excluding real estate).

Figure 62

Mrs. Tsai –Asset mix, financial assets only (ex-real estate)

Asset class	Current weighting	10 years in the future	Change
Deposits	37.5	21.4	(16.1)
Stocks	12.5	14.3	1.8
Funds	25	42.9	17.9
Insurance	25	21.4	(3.6)

Source: Gallup (Taiwan), CLSA Asia-Pacific Markets

CLSA note: The weightings and changes in Mrs. Tsai's portfolio highlight how much the inclusion of real estate can distort the weightings of other assets, and how people think about their assets. While she reported deposits at 15% of assets, they are actually 37.5% of financial assets. Based on her actual responses in the first table, her intention is clearly to increase investments in stocks, funds and insurance. However, when we look at the breakdown of financial assets the only clear winner is funds.

Subject 2: Mr. Lee

Mr. Lee is 51 years old, married and has recently taken early retirement at one of Taiwan's older listed companies, though he does not plan to really retire until he is 60 years old. His household income is about NT$175,000 per month, equivalent to about US$63,000 per year. He has two grown children already in the workforce.

Question and answer:

Do you believe that the government's current pension scheme – including the various old and new plans – can satisfy your future post-retirement financial needs? Why? When you retire, would you prefer to take a lump-sum pension payment or monthly payments (from the government pension scheme)?

At the moment I've just taken early retirement and I think we don't need to talk about that. Just today I went to the labour bureau to discuss this issue. They said I have 27 years and 163 days, and the labour bureau in recent years has announced that the monthly payment scheme is expected to start in 2009. I called to ask and the calculated the monthly payment at about NT$21,000 . . . I'm NT$43,000, the highest grade, if they calculate the total of everything together, its NT$1.97 million.

I can't find a good interest rate if I take the lump-sum, but if I take the monthly payment, it is NT$252,000 per year. Of course from a long-term perspective, if I add funds, time deposits, I can maintain living expenses of about NT$70,000 per month. My children are all grown, no financial responsibilities at home, but for me and for my future living standard, NT$21,000 per month is not enough, but if I add other investments, it should be okay. I think the labour bureau's retirement scheme can only meet about 30% of my future expenses.

What are the most important future expenses you need to think about - taking into consideration all factors such as your current age, family situation and your parents (needs)?

Future expenses/priorities: Insurance payments, living expenses, and entertainment and travel.

I'm currently 51 years old and my two children are already grown and working, so I have the advantage of having nothing to look after. Among my future financial responsibilities, the first is insurance, because my grandfather and wife very early started to buy insurance and continue to, and my children now pay their own insurance premiums, though before it was paid by us. The second is monthly living expenses for me and my wife. Because our two daughters are already married, I estimate our monthly living expenses at about NT$50,000. Third is recreation, travelling in the future, all types.

Based on the previous discussion about your future needs and expenses, what sort of investment plans have you made. For example, have you purchased real estate, deposits, stocks, funds, insurance, futures, bonds or other products, and why?

Investment products used: Time deposits mostly, blue-chip stocks, and funds.

I am extremely conservative, and the majority is in time deposits. Should be that in the 1980s I started putting money in monthly contribution time deposits, about NT$10,000 per month, continually through to the present with the current lump-sum type time deposits. At that time, time-deposit interest rates were extremely good, one year's interest was about the same as my salary, and at that time the income was really high. But currently the highest is only 2%, the very highest is not more than about 2.2%.

Separately, I've also invested in stocks and funds, funds are about 20%, and large-cap blue-chip stocks. Because my oldest works at a securities brokerage, in this area we are quite well informed. We're not like other people who trade rapidly, but rather adopt a more fixed style, trading only a few times a year.

Based on your current investment plan and the rate at which your assets are accruing, do you believe that this can satisfy your future expenses/needs for taking care of your

parents in their old age, your children's university expenses, and your living expenses in retirement? Why?

It can't satisfy the need. The first problem is living standards and changes in the price level. Just think of the houses we bought 20-plus years ago and the houses one might buy today and then you know. Now it is incredibly difficult for our children to buy even a small home. For instance, I'm 51 years old now and when I really want to retire at age 60, what will the price level be?

Now I could say NT$50,000 a month is enough, but in the future one might need NT$100,000. Whatever happens, I think we still need to work hard now, keep working – retire but don't rest - in order to achieve the level I hope for in the future. Originally I expected to retire at 55, and now my actual retirement will come at 60 years. At the rate with which my assets are accruing they might satisfy 40%.

First, I don't think I have any debt, my house is also "OK" and there is no mortgage. Ten years from now when we retire at home, I don't want to say we will be living a luxurious lifestyle, but it should be quite acceptable. But I personally really enjoy travelling, recreation, and we may not have enough to be at that level, so I would really like to engage a professional manager that can help bring my deposits down from 60% to about 20% . . . the remaining 50% I hope someone can help me manage, for instance that could increase my overseas funds . . . a professional can manage it better . . . global developments such as politics, economics, inflation, etc . . .they can go study these things.

I have lower expectations for the domestic side because I've seen too many bad experiences such as bad advisors, unstable markets, political effects, etc . . .I could increase my activity in foreign currencies and European funds, bonds. Simply speaking, from a more conservative base, such as time deposits, [I am] switching to higher-return financial products.

Have you made any overseas investments (including overseas and China, Hong Kong, and Macau)? What type of investment products have you invested in? In the coming ten years will you make overseas investments, and what types of products in what regions would you target? Why?

Yes. Currently it seems that [banks] seldom sell domestic funds, because overseas funds are the majority of what banks have introduced. Therefore I insist on buying overseas funds, because the euro, Southeast Asia developing countries, industries expanding, the probability is extraordinarily high.

Figure 63

Mr. Lee – Self-reported asset mix

Asset class	Current weighting	10 years in the future	Notes
Real estate	30	30	
Deposits	40	20	Era of high deposit rates is over.
Stocks	10	15	
Funds	10	25	Wants to find professional advice.
Insurance	5	5	Have maintained life and health coverage since I was young till now.
Other	5	5	Mostly bonds.

Source: Gallup (Taiwan), CLSA Asia-Pacific Markets

On real estate: Because at that time we bought it in cash, so there is no mortgage.

On deposits: At that time [20 years ago] I was more thrifty and hard working and enjoyed the benefits of [high-yielding] deposits, but now that is no more.

On stocks: I've always maintained about 10%, large-cap stocks, blue-chips . . . trading three to four times per year plus when companies pay stock dividends.

On funds: I've been investing for five years and hope to strengthen that. My thinking has changed a bit from before. Previously, funds earned an average of 15% per year, some as high as 20%. If I find a professional advisor who tells us a good direction to invest, we will increase the weighting, but of course we will find a few that are professional. Those that we have sought out have all been private sector because they are faster acting.

In the table below, we recalculate the weightings based on financial assets only (excluding real estate).

Figure 64

Mr. Lee – Asset mix, financial assets only (ex-real estate)

Asset class	Current weighting	10 years in the future	Change
Deposits	61.5	30.8	(30.8)
Stocks	15.4	23.1	7.7
Funds	15.4	38.5	23.1
Insurance	7.7	7.7	-

Source: Gallup (Taiwan), CLSA Asia-Pacific Markets

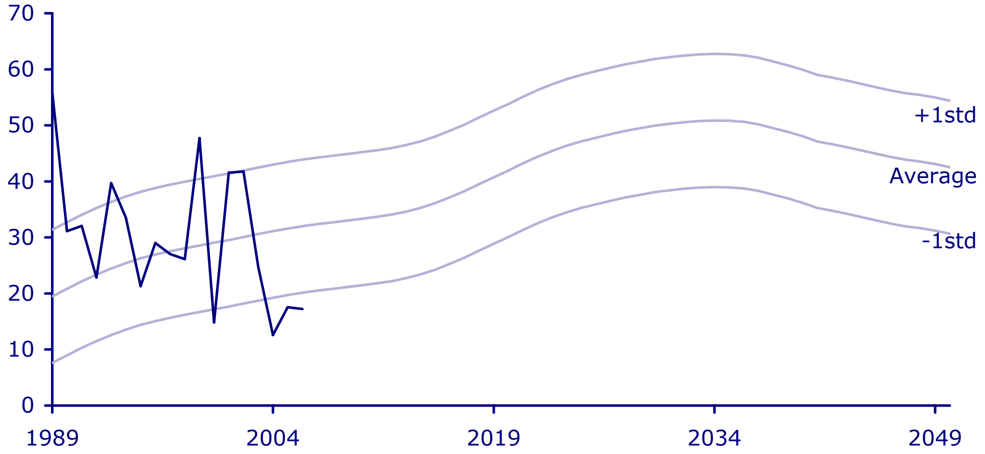
CLSA note: The change in Mr. Lee's "ideal" future portfolio very clearly shows his intention to reduce deposits and increase his investments in mutual funds and insurance. He acknowledged in the interview that he has been very conservative in his investments in the past, but that his thinking has changed. He acknowledges that the era of high-deposit interest rates is over and seems attracted to higher returns in funds.

What does this all means for Taiwan?

If the expected link between the MY ratio and Taiwan's valuations comes through, the typical Taiwan PE band should look something like Figure 65, reflecting a market that is poised for strong multiple upside.

Figure 65

Taiwan PE



Source: CLSA Asia-Pacific Markets

Given the continued growth of insurance funds, annuities, and other investment avenues to compensate for pension concerns, expect Taiwan's newly-middle-aged investors to push this market notably higher.

Japan: Practitioners' view - Banks and brokers

To get a sense of how baby boomers are showing up on the radar of the banks, we spoke to a senior individual in the product development group at on of Japan's larger financial groups.

A financial house's perspective - Nomura

Our research indicates that as the average age of a population rises the demand for retirement savings products (particularly equities) increases. Is the "soon-to-retire" market an important demographic for your business?

We have been doing research for "soon-to-retire" [baby boomers] regarding their attitude to the asset-management and investment funds after retirement. We compare those attitudes by various age groups. What we have done in the past were: 1) the attitude survey toward investment funds for baby boomers/senior people (2005), 2) same for baby boomers/juniors of those (2006), 3) same for baby boomers (2007). The result can be seen at our website. Those surveys were conducted by group interviewing and questionnaires through internet. We are reflecting those results to our product developments and services to the selling agents and investors.

CLSA note: The group that is typically referred to as baby-boomers in Japan is actually part of a mini-baby boom that started just after WWII. However, after just three years of an elevated birth rate, births fell off drastically again to levels well below the pre-war average, not to recover for more than a decade. The survey above noted that the 'baby boomers' are the least concerned about retirement issues, but that the younger generations are much more worried. This fits in with the view that MY-ratio driven buying will lead to increased investment participation.

Japan is one of the fastest ageing populations in the world; do you see any evidence that this is impacting the demand for your products? If so can you provide examples?

Demands for Global Attractive Dividend Stock Fund, Nomura Global All Stars and My Story are growing. Those are mainly targeting retired people. But we do not know exactly which group of people is buying more of those investment funds.

Global Attractive Dividend Stock Fund: the funds are investing in companies of which dividend yields are higher. One distributes the income every three months and another one pays every month.

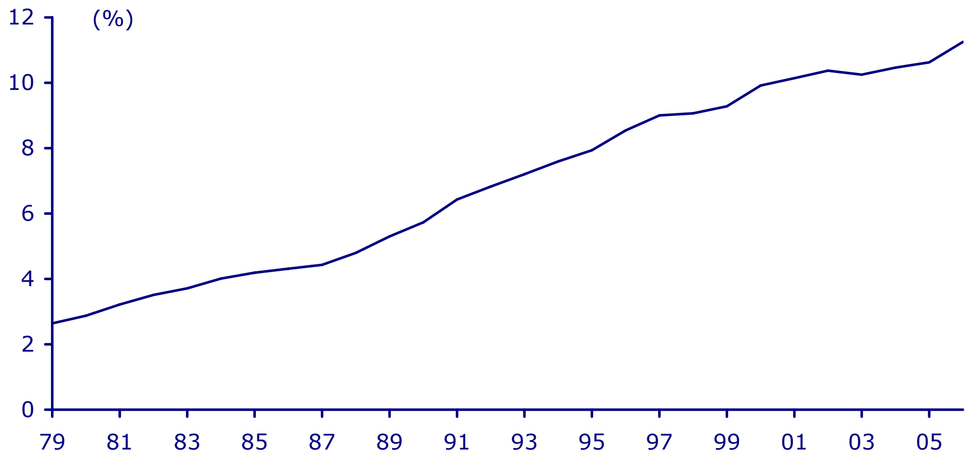
Nomura Global All Stars: funds investing in 10 different asset classes (40% to high major government bonds - AUD, EU, US and JPN, 40% to equities/Reits – JPN equities, Developed markets equities, Emerging markets equities and global Reits, 20% to high yield bonds – emerging markets bonds, high yield bonds. This is a fund of funds. They distribute the income every another month.

My Story: funds investing in 75% global bonds and 25% global equities, there are several types and one which pays the profits every other month and no currency hedged is popular.

Should we expect Japanese to increasingly shift out of cash into other asset classes?

Investment funds share only 4% of individual's financial assets as of September 2006. Comparing with US individual's 14%, the share of Japanese individuals is low and we expect the rate steadily grows to 10%. In order to capture the needs, we'd like to keep enlightening the merits of investment funds through seminars, internet web site etc. We think that My Story [profit distributing type] fund of funds like Global All Stars and balanced funds are our core funds but also present other types such as country funds (ie, Indo fund), BRICs/global emerging funds etc to cover diversified needs of individuals.

Figure 66
Pension reserves as % of Household Financial Assets



Source: BOJ – Flow of Funds, CLSA Asia-Pacific Markets

Could you give us some examples, are your fund managers developing new types of funds to target investors planning for retirement?

We keep doing the attitude survey for individuals and develop our new products to reflect their demands. But we'd like to decline to make comments on the details of individual products we are studying.

An insurance firm perspective - Millea

Our research indicates that as the average age of a population rises the demand for retirement savings products (particularly equities) increases. Is the "soon-to-retire" market an important demographic for your business?

Yes. Millea has very comprehensive range of products which includes pension products like 401k plans which are part of personal accident scheme in Tokio Marine and Nichido, a 100% subsidiary. The trend has also fuelled the increase in variable-annuities sales at Tokio Marine & Nichido Financial, which is a 100% subsidiary of Millea Holdings. Variable annuities are pension products popular with relatively older people nearing retirement.

There are two key areas to consider when it comes to developing your customer offering and systems. One is product development and the other is advice. What is the relative priority of each for Millea?

The needs of customers changes rapidly. For annuity products, we introduced our product last spring and it has been selling well. We do not see a need to change such products. However, we are also developing more products managed by Tokio Marine Asset Management.

Japan is one of the fastest ageing populations in the world; do you see any evidence that this is impacting the demand for your products? If so can you provide examples?

It is fuelling growth of annuity products which is treated like a pension products packaged with life insurance. The number of new policies grew 150% in FY3/07. We also have the best selling product in 401k.

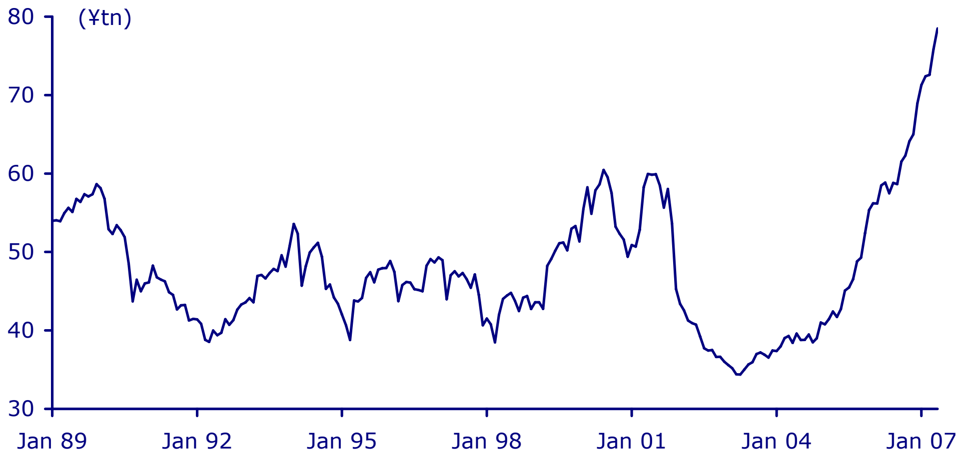
Should we expect Japanese to increasingly shift out of cash into other asset classes?

Yes. This is a general trend that has attracted great attention by Japanese financial institutions. This is the reason that there is strong growth in investment trusts or annuities business.

Domestic growth in asset management is important. However, we see also great potential in the regional markets. For example, Tokio Marine Asset Management is expanding, especially in Singapore to leverage on the regional markets.

Figure 67

Japan Investment Trusts: Total Assets



Source: CEIC, CLSA Asia-Pacific Markets

Could you give us some examples, are your fund managers developing new types of funds to target investors planning for retirement?

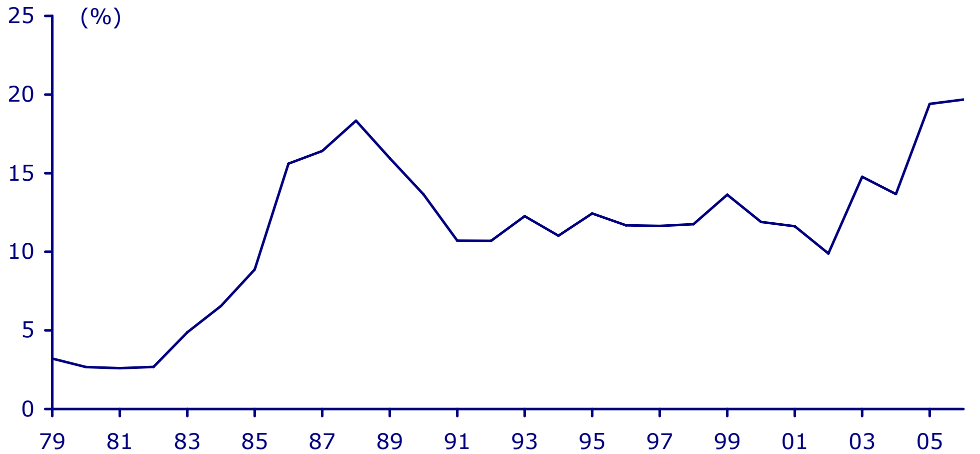
Variable annuity products are effectively pension products. Generally, we see our customers as retirees or middle-aged working clients investing for retirement purpose.

What about the national and corporate pensions – are they a threat or an opportunity for your business and why?

Tokio Marine Asset Management has 53% of our managed assets from public pension, 40% from private pension and our assets have grown over the past three years to Y3.3 trillion. We would see them as customers or potential customers.

Figure 68

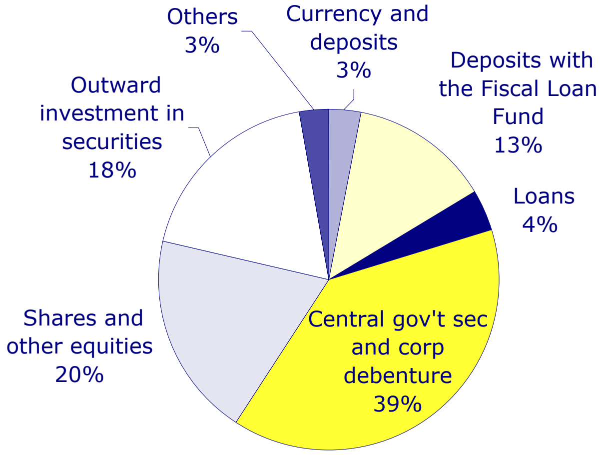
% of Share & other equities in Japan Pension Assets



Source: BOJ – Flow of Funds, CLSA Asia-Pacific Markets

Figure 69

Distribution of Japan pension assets (FY 2006)



Source: BOJ – Flow of Funds, CLSA Asia-Pacific Markets

Personal interview

Profile: Upper-middle-class end

Date of birth:	1961 (age 46)
Offspring:	-
Marital status:	-
Education:	Tokyo University
Current profession	Investment banker

Figure 70

What is your biggest financial concern?	
a. Educating children	
b. Purchasing a house	
c. Medical expenses	
d. Everyday living expenses	
e. Retirement planning	√
f. Others:	

Source: CLSA Asia-Pacific Markets

We recently learned that our national pension on its own would not be sufficient to meet our financial needs after retirement. Right now we are trying to establish the best way to prepare for retirement.

Figure 71

How is your portfolio structured and how is that changing?	
a. Real estate	0
b. Savings	70
c. Equities/mutual funds	30
d. Derivatives	
e. Others	

Source: CLSA Asia-Pacific Markets

Have you been preparing for retirement? If so, since when?

Yes, about five years ago

At what age do you plan to retire?

As soon as possible.

Have you ever calculated how much you need for the retirement?

Roughly yes. I suppose current saving is enough for after retirement cost.

Figure 72

Could you rank for us you preferred means of preparing for retirement?

a. Savings	1
b. National pension	2
c. Real estate rentals	
d. Equities/mutual funds	3
e. Retirement allowances	
f. Individual pension	
g. Inheritance	
h. Social aid	
i. Others	

Figure 73

When and where was the last time you had any financial advisory services from a professional financial institution?

a. Banks -	√
b. Brokers -	
c. Insurers -	
d. Others -	

Source: CLSA Asia-Pacific Markets

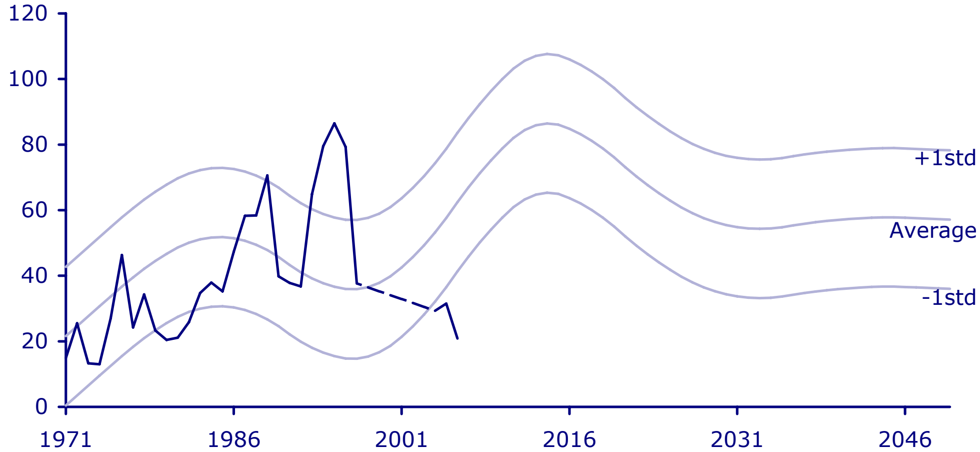
No, need to be advised.

What does this all means for Japan?

If the expected linke between the MY ratio and Japan's valuations comes through, the typical PE band should look something like Figure 74, showing Japan set for strong multiple-driven gains. While the long-anticipated shift out of hefty cash positions is largely targeting overseas instrument and currencies at this stage, the unlocking of this mass of assets from the previous "safe" form of yen suggests that in years to come, retail investors will be more willing to allocate from cash into a wider variety of liquid investments. This can only benefit Japanese equity.

Figure 74

Japan PE



Source: CLSA Asia-Pacific Markets

What is more, given Japan's more developed pension and funds market, the pattern of allocation within the system is also important. Looking at data from 1970 forward, it seems that pension fund managers increase their equity levels to take on additional risk when the demographic profile demands. Note that the equity allocation climbs in a pattern roughly mimicking the MY ratio, suggesting that there is room for further upside to move equity allocations to historical highs.

Epilogue

The MY relationship between demographics and markets has not only stood the test of time across a wide range of markets, but more importantly fits in with common sense. Much as we expect demographic trends to impacts a certain company's earnings, we should also expect an increase in demand for investment products to move markets. If one believes in the pricing power of supply and demand, the lifecycle view of investing should be considered when looking at long-term valuation trends.

Of course in the more immediate future to which all of us are held accountable, the current questions of liquidity, inflation resurgence, and the strength of the global economy will far outweigh the plodding and long-dated influence of demographically-driven demand for equity. Yet knowing that one is facing these constant short-term questions in an environment where the long-term trend is tilted decidedly upwards keeps the perturbations in perspective, and the target on the long-term upside.

Furthermore, as Russell Napier points out in his *Solid Ground: Six Degrees of Separation*, this is one of the factors that suggests the possible (dare we say the dreaded D-word) decoupling of Asia from its US market linkage. Russell points out that the current correlation is largely due to tradition, and that while traditions often linger on, they don't last forever. Whether one is looking at the logic, the historic measures from across markets, or the anecdotal evidence from this handful of investors and fund managers across Asia, investors should prepare for rising equity valuations throughout much of Asia over the years to come, and crucially, concurrently falling premiums in the US markets.

Appendix 1: Methodology

A. Computations

I. Real price index

Real price index = Market index / Consumer price index

II. Medium-young (MY) ratio

MY ratio = Population age 40-49 / Population age 20-29

III. Regression Model

$$RP_t = c + bMY_t + e_t$$

Where RP is the real price index and MY is the medium-young ratio.

Augmented Dickey-Fuller Unit Root Test

Since the population data is slow-moving and there is a danger of finding spurious correlation, what is reported is the t-statistics of the Augmented Dickey-Fuller (ADF) unit root test on the residuals of the regression.

ADF test are derived from the regression of the differenced residual on the residual without a constant and with one lagged variable. The critical levels for the 2.5% and 5% confidence levels are -3.05 and -2.76 respectively.

B. Population data

Population data are from United Nations World Population Prospects: The 2004 Revision Population Database. United Nations data is used whenever the country's statistics bureau website does not provide for long historical data. UN data provides population data in an interval of 5 years. Yearly data was interpolated from the computed population growth rate.

C. Indices

The following major country indices were used:

Country indices

Country	Major Index
Hong Kong	Hang Seng Index
India	Mumbai Stock Exchange Sensitive Index
Indonesia	Jakarta Composite Index
Japan	TOPIX - Tokyo Stock Price Index
Korea	KOSPI - Korea Composite Index
Malaysia	Kuala Lumpur Stock Exchange Composite Index
Philippines	Philippine Composite Index
Singapore	Straits Times Index
Thailand	Stock Exchange of Thailand Index
Taiwan	Taiwan TAIEX Index

Source: CLSA Asia-Pacific Markets

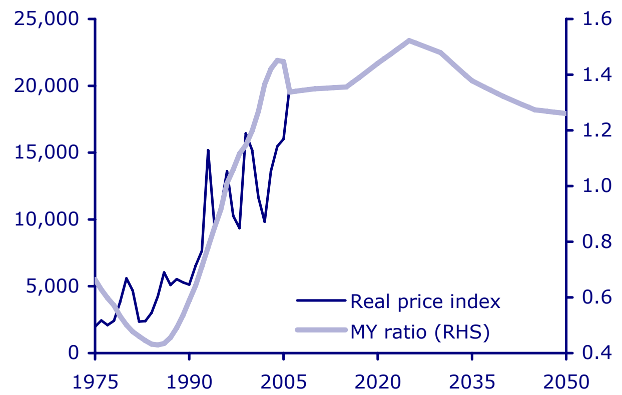
Appendix 2: Real index vs MY ratio

Regression model: $RP_t = c + bMY_t + e_t$

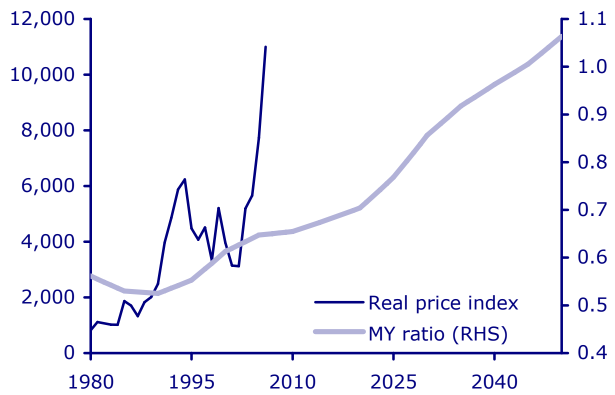
Regression result

Country	No. of samples	Coefficients		Adjusted R2 (%)	ADF t-stat
		Intercept	MY Ratio		
Hong Kong	32	(1,824)	12,395.71	71.72	(3.39)
India	28	(16,480)	35,173.59	34.99	(1.39)
Indonesia	24	2,599	(3,330.06)	13.40	(2.62)
Japan	58	(1,323)	2,667.28	69.11	(3.40)
Korea	27	716	134.50	(3.57)	(2.62)
Malaysia	30	(104)	1,473.89	19.36	(2.41)
Philippines	20	8,506	(12,425.54)	13.28	(1.91)
Singapore	22	784	894.66	40.77	(2.34)
Thailand	32	831	(255.53)	(2.76)	(2.11)
Taiwan	33	(1,041)	8,145.11	27.21	(2.30)

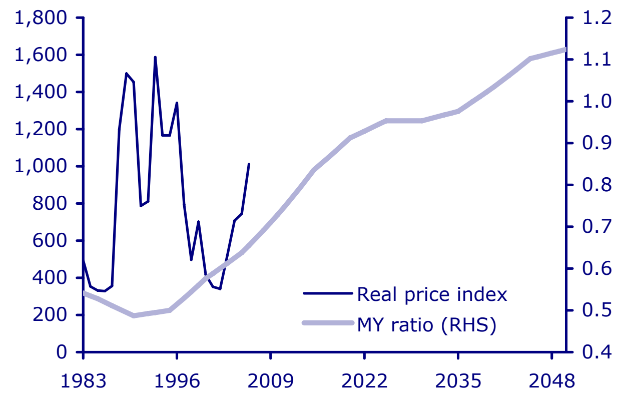
Hong Kong



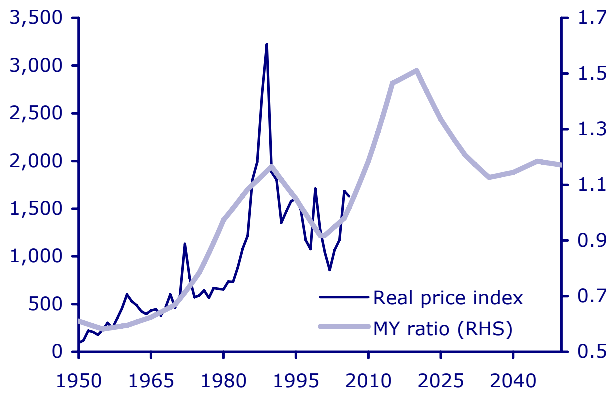
India



Indonesia

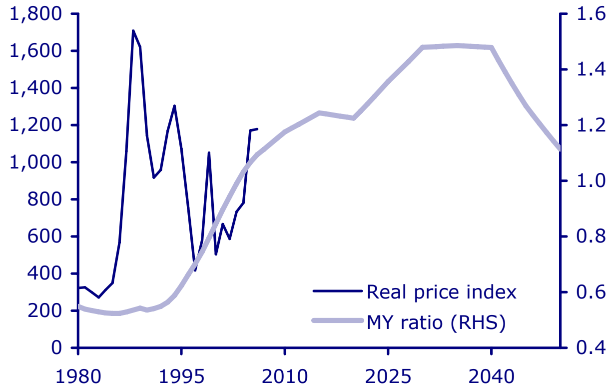


Japan

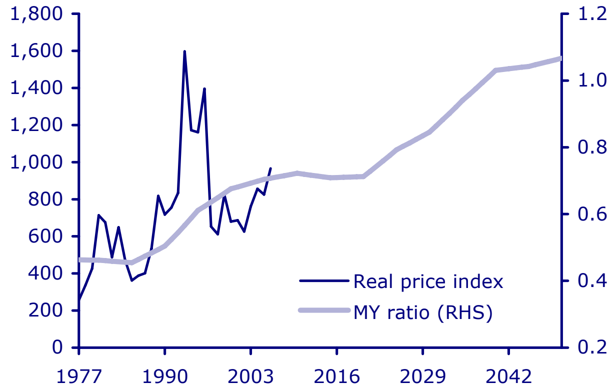


Source: CLSA Asia-Pacific Markets

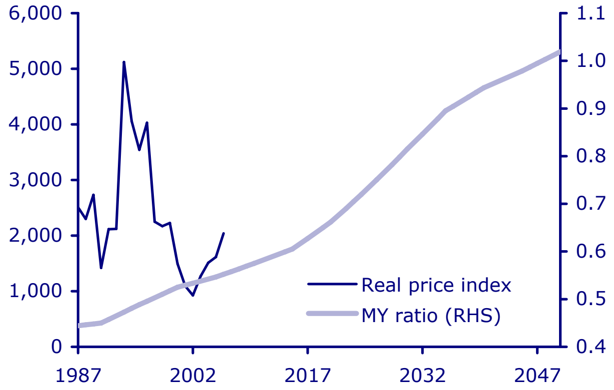
Korea



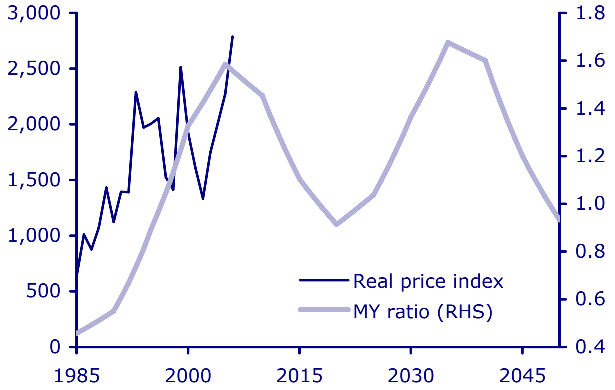
Malaysia



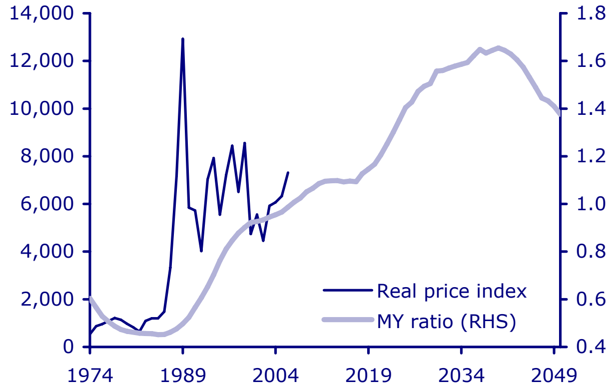
Philippines



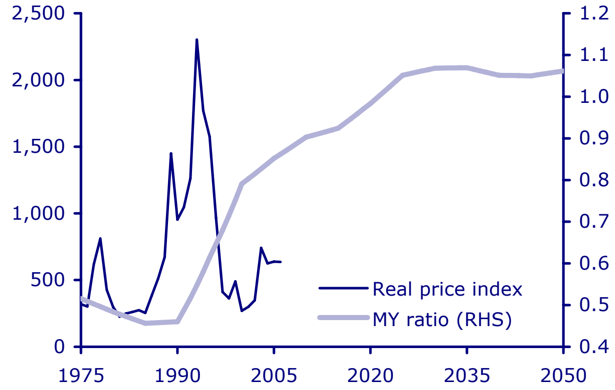
Singapore



Taiwan



Thailand



Source: CLSA Asia-Pacific Markets

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