thebigpicture

guideposts for the private investor

Week Commencing 13 January 2003

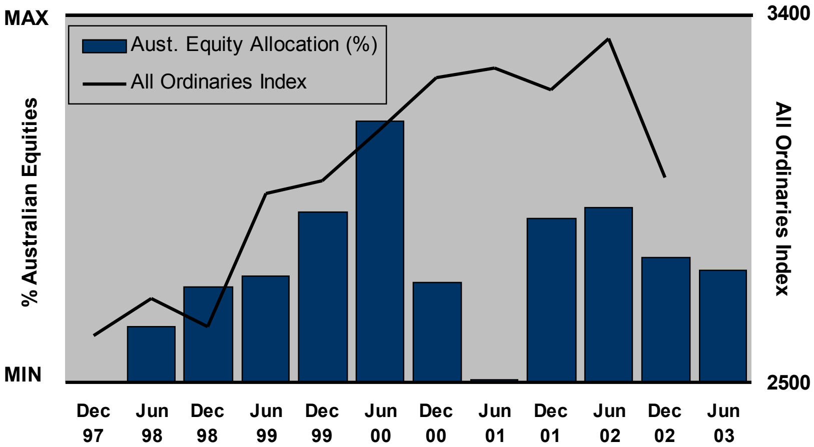
ASSET ALLOCATION REVIEW

***thebigpicture* asset allocation model suggests maintaining a relatively modest exposure to domestic equities at the beginning of 2003 with cash levels remaining relatively high.**

The market value/profit relationship has not been re-balanced sufficiently to commit more funds to equities. Nor, according to the model, is the momentum of international activity sufficiently supportive.

The diagram illustrates how the model suggested relatively high (and rising) equity exposures until the first half of 2000 and, while the Australian market was approaching its peak during 2000/01, a cut-back to minimal levels. It suggested some rebuilding of Australian equity positions during the third quarter of 2001 (at a time of some market weakness) and a relatively low (and slightly reduced) exposure since mid-2002.

Australian Equity Allocations and Market Movements



The diagram shows the "raw" outcomes from the model without any adjustments to take account of judgements about market conditions at the time.

The actual percentages represented by the minimum and maximum allocations will depend on the profile of individual investors and the ranges for each asset class within which they are able to move, based on their own financial plans.

In its full form, the asset allocation model seeks to allocate funds amongst domestic equities, international equities, bonds and cash. Its primary inputs measure changes in the momentum of economic activity and variations in monetary conditions.

A fuller report on ***thebigpicture*** asset allocation analysis is available by contacting admin@thebigpicture.com.au. ***thebigpicture*** Economics provides a regular update service for subscribers. ***thebigpicture*** newsletter highlights some of the key elements of the asset allocation approach and, from time to time, reports on some of the individual indicators comprising the 30 indicator asset allocation model.

Publishing and Subscription Information

thebigpicture guideposts for the private investor is published by *thebigpicture* Economics (ABN 71 040 787 936). The author, John A Robertson, while working in Australia, London and New York, has over 20 years experience in international financial and commodity markets, corporate strategy, financial and business evaluation and government policy. He has been Chief Economist and a director of a leading Australian investment bank. He has been a top-rated institutional equity analyst and has marketed investment advice in all the major international financial centres.

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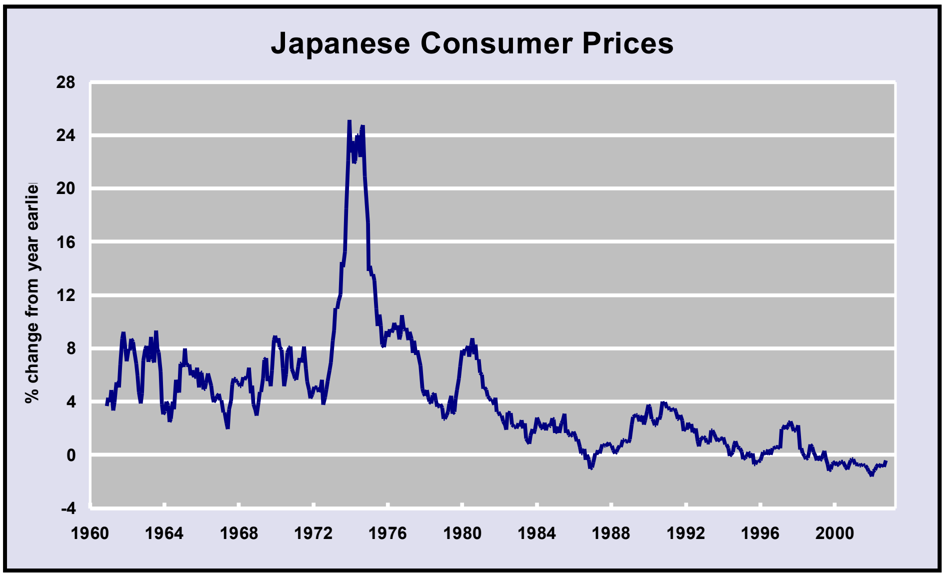
***thebigpicture* Economics**
ABN 71 040 787 936
PO Box 333, Malvern
Vic 3144

THE WEEKLY CHART SPOT



"Falling prices are seen as one element in a policy quagmire from which Japan has been unable to extricate itself for a decade…. Competitive markets which keep prices low are now seen as putting pressure on company profitability, making it more difficult to justify investment and repay already outstanding debt."

Japan's rate of inflation (measured by the change in the consumer price index) has been below zero since the beginning of 1999. Over the 12 months to November 2002, Japanese consumer prices fell by 0.4 per cent.

Of course, Japanese inflation has been relatively low for a quarter of a century since the economy recovered from the oil price shock of the early 1970s which took its inflation to 25 per cent. Since the early 1980s, Japanese inflation has tended to be 0-4 percentage points lower than US inflation rates, for example, as the second chart illustrates.

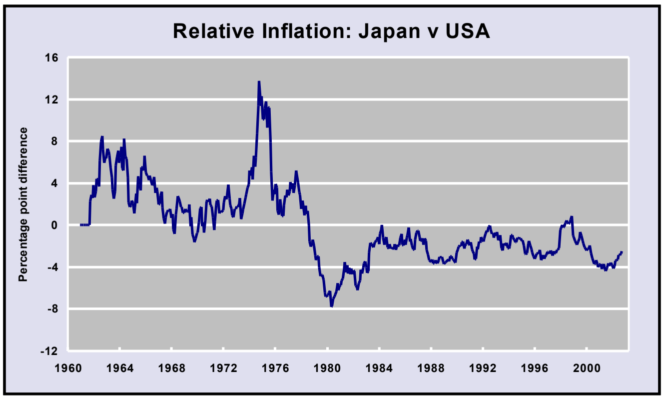
Significantly, Japan's relative inflation performance remains within the historical 0-4 percentage point range. Now, with global inflation rates having been taken down a notch or two so that US inflation, for example, is running at around two per cent, maintaining its historically 'better' inflation performance means that Japanese prices are being forced lower.

Japan is not getting the accolades it once received for this performance. Falling prices are seen as one element in a policy quagmire from which Japan has been unable to extricate itself for a decade: low growth, near zero interest rates, a financial system burdened by non-performing loans, falling equity values, an ageing population and a timid political establishment which has pinned its hopes repeatedly on minor and inadequate policy adjustments whenever it has been forced to act.

Competitive markets which keep prices low are now seen as putting pressure on company profitability, making it more difficult to justify investment and repay already outstanding debt.

The Bank of Japan, having already reduced interest rates to zero, has little flexibility with which to rekindle business or consumer spirits. And, government debt, at 150 percent of GDP and far and away higher than in other OECD member countries, is making government officials reluctant to consider a more dramatic fiscal response.

Nonetheless, there is considerable pressure on the Japanese government to take more meaningful action to boost growth in what is still one of the world's three largest economies. And the calls are for more radical action.



Data sources: Statistics Bureau, Ministry of Public Management, Home Affairs, Posts and Telecommunications; US Bureau of Labor Statistics.

The Weekly Chart Spot cont'd

There is pressure to restructure key sectors of the economy as part of a longer term approach to achieve more robust rates of growth.

And, one senior IMF official has also argued recently that Japan should initiate a reflation by essentially printing money. How much? As much as it takes! Unfortunately, getting the amount precisely right is about as likely as getting the golf ball in the cup with a shot out of the bunker, through trees and over water.

In having to assume that they will miss the hole, policy makers are faced with two broad alternatives. One is that nothing much changes except that the latest attempt is also seen as having failed and people become even more sceptical that there can be any meaningful improvement in conditions.

The other alternative is that higher rates of activity can be initiated but that, in doing so, inflation will be out of control and the currency will depreciate sharply. Subsequently, further action will have to be taken to restore some form of equilibrium, a bumpy ride which is likely to take many years to complete. Nonetheless, given the choice, even such an unpalatable outcome might have to be confronted.

More Shareholders Voting cont'd

(Continued from page 4)

Historically, the proportion of shareholders voting at meetings of Australian public companies has been quite low. This has been changing as more institutional shareholders have accepted the idea that they should exercise their rights to vote as well as exercising their influence behind the scenes in one-on-one meetings with management and directors.

The record of proxy lodgment at the most recent round of annual general meetings indicates that around 40% of votes are likely to be exercised among the major listed companies. The proportion is higher, understandably but misleadingly, where there is a single large shareholder in cases such as The News Corporation or Telstra.

Removing the effect of the large single shareholder where that is relevant shows that the remaining shareholders are generally less likely to participate than where the share registers are more open. Why that should be so is unclear but it would be unfortunate if shareholders felt that their influence, in these instances, was so limited that the effort was not worthwhile.

thebigpicture has a suggestion. While a radical and, no doubt, uncomfortable alternative, a minimum proportion of votes should be required before a resolution can be passed. Having such a requirement would ensure that a company has to actively canvas support. If it cannot get at least, say, 60 per cent of shareholders to even give a resolution their attention, let alone vote in favour, it is hard to accept that there has been adequate scrutiny or that there is sufficient support for it to be accepted as corporate

Voting Turn-Out For Selected Larger Companies

	% of shares voted	
Company	Actual	Adjusted[1]
Publishing & Broadcasting	73.7	*57.9*
Telstra Corporation	64.7	*29.3*
Coles Myer	60.5	n.a.
Westfield Holdings	57.5	*40.7*
AGL	50.9	n.a.
Brambles Industries	49.8	n.a.
Orica	48.5	n.a.
BHP Billiton	45.8	n.a.
Amcor	44.4	n.a.
Tabcorp Holdings	44.0	n.a.
CSL	43.8	n.a.
Westpac	43.2	n.a.
Qantas Airways	42.5	*27.0*
ANZ Bank	42.5	n.a.
Fosters Group	42.0	n.a.
Mayne	41.5	n.a.
Lend Lease Corporation	41.3	n.a.
Woolworths	40.5	n.a.
Harvey Norman Holdings	39.5	*31.6*
National Australia Bank	38.8	n.a.
Wesfarmers	37.6	n.a.
MIM Holdings	35.1	n.a.
The News Corporation	34.9	*7.3*
Southcorp	33.6	*19.1*
Commonwealth Bank	33.0	n.a.
Insurance Australia Group	26.5	n.a.

1. To exclude the effect of a large shareholder.

"….a minimum proportion of votes should be required before a resolution can be passed. Having such a requirement would ensure that a company has to actively canvas support."

Executive Rewards: Choosing Peers

Looking for alternatives to executive share schemes is taking some companies further away from an alignment with shareholder interests.

A model becoming more popular involves compiling a group of 'peer' companies against which share price performance is measured. To the extent that the price performance of a company is better than the defined peer group, its executives are rewarded with shares. Typically, in this approach, rewards accrue to the extent that the company's share performance exceeds the median for the group of peer companies. Usually, median performance might lead to 40 per cent of the potential reward being received. Top percentile performance would deliver the maximum possible reward.

At face value, this approach has some appeal. There is an element of relative performance. Executives do not get big rewards simply because bond yields fall, for example, and stock prices generally rise. Nor are they penalised for a general decline in prices over which they have no control.

The fault in the logic is that the choice of peer companies reflects personal judgements. Executives in poorly performing sectors will be prone to choose like companies for their peers.

The risk for shareholders is that executives in poorly performing sectors will be rewarded in line with the best performing executives in the best performing sectors. This is a wholly inappropriate outcome.

Far from being in the interests of shareholders, the peer stock approach rewards executives even where the company might be losing competitiveness against the market as a whole. It matters little that pie making is technically different from banking because both are making a claim on the same pool of capital and must be competitive against one another.

The approach has several other shortcomings:

- companies can drop out of the peer group either through business failure or acquisition causing a shrinkage in the number of companies against which comparison is being made;
- new entrants to the industry are not automatically included;
- rewards are accruing when a company achieves median performance which is not necessarily a sufficiently high hurdle against which to be judged for special consideration.

It would be preferable to measure performance against broadly based and widely recognised share indices such as the ASX 200 or 100. This would take away the element of self interested judgment which can taint peer selection. Moreover, it forces executives to focus on the reality: that they must be competitive in the overall capital market to have a sustainable business.

"The risk for shareholders is that executives in poorly performing sectors will be rewarded in line with the best performing executives in the best performing sectors. This is a wholly inappropriate outcome."

More Shareholders Voting: But Not Enough

Despite some increase in voting turn-out over the years, directors of major companies can have resolutions passed with only minority shareholder support. This is not a satisfactory position.

Management and boards are subject to little countervailing influence on important matters of governance. And yet, shareholder democracy and the ability to hold boards accountable depend on the maximum possible number of shareholders taking part actively in those decisions where they must be consulted.

Even though the number of opportunities to do so is limited, the knowledge that shareholders could become involved will modify the actions of directors and management and bring their decisions more into line with shareholder interests than would otherwise be the case.

(Continued on page 3)