

thebigpicture

guideposts for the private investor

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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

CORPORATE REFORM: MAKING IT HARDER TO VOTE

Moves to reduce the notice period for meetings of shareholders from 28 days to 21 days do little to improve the prospects of shareholder participation.

The proposed changes go to the heart of what role assemblies of shareholders are to play. The need for shareholder approvals under certain circumstances adds another layer of protection for investors whether or not it represents an inconvenience for the board and management. The proposed change seems to place more weight on company convenience and less on shareholder scrutiny.

In fact, shareholder meetings have rarely exercised much scrutiny. Until recently, institutional investors, despite representing the majority of shares in larger companies, did not generally bother to participate. Even now, passage of resolutions can be achieved with only a minority of shareholders supporting them.

In the ideal, all shareholders would attend and participate at shareholder meetings. This would ensure transparent consideration of issues and adequate consideration of all aspects before votes were taken. It would ensure that there were genuine majorities in favour before resolutions were passed.

The proposed changes fail to recognize the practicalities of Australian company shareholding structures. Institutional fund managers often represent the majority of shares and, within this group, overseas fund managers might account for up to 30% (or more) of shares. The latter group are usually represented by nominee companies on the share register.

Reducing the time between notice and meeting makes it more difficult for the paperwork to flow back and forth among companies, the share registry, nominee and principal and for there to be adequate consideration of the issues within this loop.

Effective scrutiny is best achieved with maximum participation by professional investors but, for that to happen, there must be sufficient time allowed.

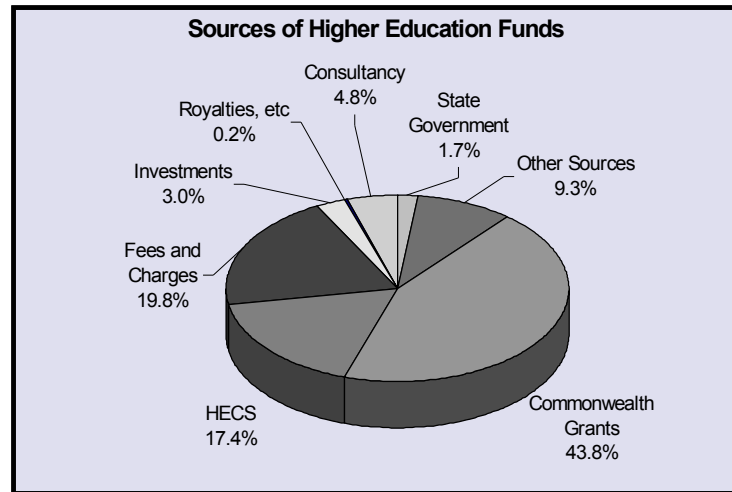
In earlier commentaries, *thebigpicture* has argued that there should be a minimum number of votes cast for resolutions to be legitimate. This is a somewhat radical approach which imposes an added burden on companies but deals with a fundamentally important matter: whether shareholder meetings are supposed to be a meaningful forum with a role in corporate decision-making or simply window dressing.

Voting Turn-Out For Selected Larger Companies

Company	% of shares voted	
	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.

THE WEEKLY CHART SPOT



Source: Department of Education

“...this seemingly radical change in funding arrangements has occurred with little public debate about the nature of the government’s role in education. This philosophical capitulation is not confined to the educational sector. There is a bigger picture of a government seeking to hive off as many of its service functions as possible.”

Australia’s official higher education statistics show radical changes in the funding of tertiary education. The latest statistics, which are for 2001, show that a little under 45% of the revenue received by the higher education sector came from the Commonwealth government.

From being a system reliant predominantly on Commonwealth government funding, higher education is now reliant predominantly on sources other than the Commonwealth government.

As a nation, Australia used to draw an important distinction between the way in which it went about funding education (with universal access based on merit) and the way, for example, education was funded in the USA with its emphasis on ability to pay. The occasional student protest aside, this seemingly radical change in funding arrangements has occurred with little public debate about the nature of the government’s role in education.

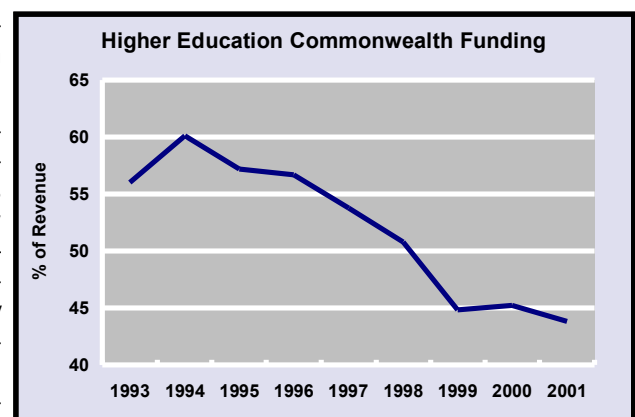
This philosophical capitulation is not confined to the educational sector. There is a bigger picture of a government seeking to hive off as many of its service functions as possible. Health is another area in which there are some pressures for people to pay their own way with less bulk billing, for example, and rapidly rising insurance charges.

Another area is retirement incomes, where there is a far heavier emphasis on individuals providing for their own retirements and being correspondingly less reliant on the provision of government services.

Many of the changes are arguable propositions: that the private sector and individuals should take more responsibility for the provision of needed services. Unfortunately, the government, in achieving many changes, is failing to have individuals understand fully their new responsibilities. It is tending to effect changes without

widespread debate about their implications and, consequently, without preparing the population for what is required of them in terms of their longer term financial planning.

These tendencies have some implications, too, for sound policy decision-making which usually works best when choices are made explicitly with due regard for the consequences. The current government has frequently bent to some of the louder demands for funds when it has suited its electoral prospects, effectively drawing funds from other services but usually not admitting the choice when the decisions are being made.



HOUSING: THE PRICE CYCLE CONTINUES

The Australian housing cycle is an unintended beneficiary of Iraq failing to disarm.

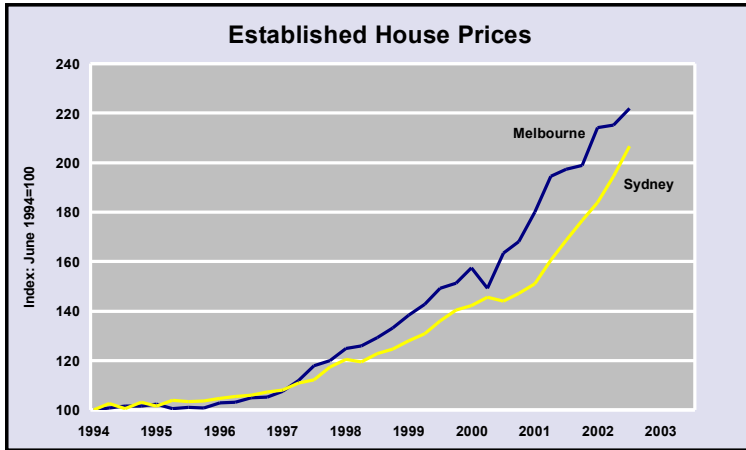
The Australian Bureau of Statistics has reported that prices of established houses rose by an average 4.8% during the December quarter of 2002. The weighted average increase in the eight capital cities

by a rise in interest rates. There is no reason to believe that this cycle will be any different in the end result. However, it is proving to be different in terms of how long it plays out because of the peculiar set of contributing conditions.

Helping, has been maintenance of relatively low interest rates. Whereas the Reserve Bank had appeared ready to begin the upward part of the cycle in rates last year, the persistence of drought in Australia and declining rates of growth overseas put the cycle on hold. Now, there is a broadening sense, supported by overseas economic weakness and the prolonged lead-up to an attack on Iraq, that the next interest rate change

by the RBA might be down. That being so, policy might be generally supportive throughout most of 2003. Some time in early 2004, assuming calmer geopolitical conditions, the interest rate cycle might begin to have a negative impact. Housing prices, therefore, could still fall steeply despite the evident short term

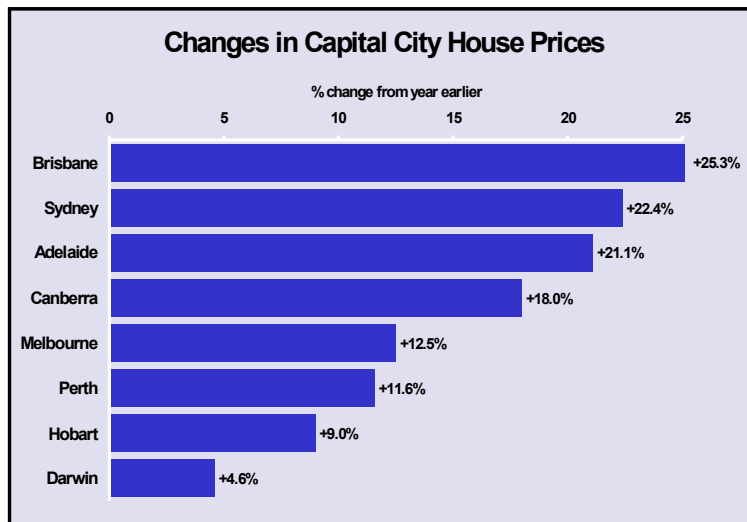
"...history also says that even if prices fall at the end of the cycle they subsequently do rise again. There is nothing evident now which leads to this pattern being questioned."



over the year to the December quarter was 18.4%.

Over the year, the largest price increases were in Brisbane followed by Sydney and Adelaide. The rate of price increase in Melbourne appeared to decelerate in the second half of 2002. Nonetheless, prices in both Sydney and Melbourne have risen by approximately 50% over the past three years.

The continuing housing price inflation has played an important role in sustaining the rate of economic activity. With equity market values having declined, buoyant housing prices have helped to sustain the wealth perceptions of individuals and maintain consumption spending at higher levels than would otherwise have been the case.

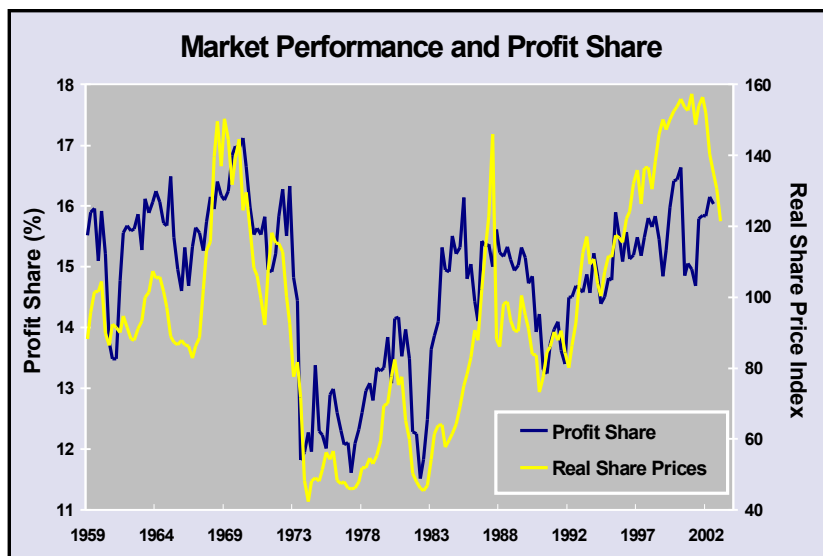


In similar fashion to the late 1980s, a housing cycle has been maintained beyond the equity cycle in part because it represents a more secure investment alternative than the equity market.

Generally, the housing cycle is terminated

buoyancy. But history also says that even if prices fall at the end of the cycle they subsequently do rise again. There is nothing evident now which leads to this pattern being questioned.

EQUITIES: THE VALUE GAP CLOSES



Relatively resilient corporate profits and a weaker equity market are achieving the adjustment which was necessary to realign equity values.

thebigpicture observed in August last year that Australian corporate profits would need to be 20-25% higher to justify the then prevailing market levels. That gap has been eliminated.

According to the Australian Bureau of Statistics, gross operating surplus of Australian private non-financial corporations increased at an annualized 2.8% in the December quarter to be 8.9% higher than in the December quarter of 2001. The rate of increase decelerated from the 19% annual rate of increase reported for the September quarter.

Gross operating surplus equates broadly with profit after tax but before interest and depreciation. The ABS report covers a broader range of companies than those listed on the Australian market. However, as it measures income generated from within Australia, it does not take account of income from overseas business activities.

Despite these differences, the ABS statistics provide one of the few indicators of overall company profitability which is available in the Australian context and economy-wide profit movements have provided a reliable indicator of whether the market has moved out of line with the un-

derlying profitability of the Australian economy over the past forty years.

In the chart, profitability is measured by the share of gross operating surplus in total non-farm gross domestic product. That is, the blue line will rise if the growth in corporate profits outstrips the growth in the economy (excluding the rural sector) as a whole.

The level of the Australian market has been adjusted for general price movements so that the yellow line shows the extent to which the market is rising faster than or more slowly than prices generally.

Historically, when profit growth has exceeded the growth in the economy (a rising blue line), the value of the share market has risen more strongly than the general level of prices (a rising yellow line).

Now that the gap has closed, the Australian market should be better value. However, there is a continuing risk in the other direction: that the market continues to fall below the level indicated by corporate profitability.

The downside might eventuate if investors lose confidence in the ability of the corporate sector to maintain its profitability. It might require one or two reporting periods in which companies can convincingly meet or beat the expectations held before confidence is restored and the market begins to move ahead in line with the ongoing profit growth rates.

“The downside might eventuate if investors lose confidence in the ability of the corporate sector to maintain its profitability. It might require one or two reporting periods in which companies can convincingly meet or beat the expectations....”