

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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THE AGM SEASON: LET BATTLE COMMENCE

Shareholder activists are ready for another AGM season. Directors are bracing their defences. And, amidst the posturing, many of the real needs of genuine investors are forgotten. There is a better way.

For several years, annual meetings have been battles between shareholder activists and directors. For the activist, excluded from the more intimate contact afforded institutional investors, the AGM is the only opportunity to have a say about the running of the company. Directors, intent on keeping control of the meeting as it fulfils some minimalist statutory functions, view the activist as a misguided and unappreciative hijacker of the proceedings.

In the end, the AGM seems to satisfy few. One business lobby group recently suggested that it could be abolished because of its limited practical role.

One reason for the meetings being so unsatisfactory is that the key indicators which drive investment performance are largely ignored by all participants as they are, more generally, by accounting standards and corporations laws.

The legal system is designed to click into action in the event of imminent catastrophic failure. There are no graded sanctions in the law for management performance which falls slightly short of complete failure or which is simply below average.

Companies are told how to report performance. They are not required to identify shortcomings and change if improvement is needed.

Nor is there anything in the corporations laws - existing or proposed - which defines what a company's goals should be. Consequently, companies do little to address this most important of all elements of corporate governance.

Here's a test to prove the assertion. How many of the companies among the top 100 Australian listed stocks are able to say "yes" to each of the following guideposts? Are there any?

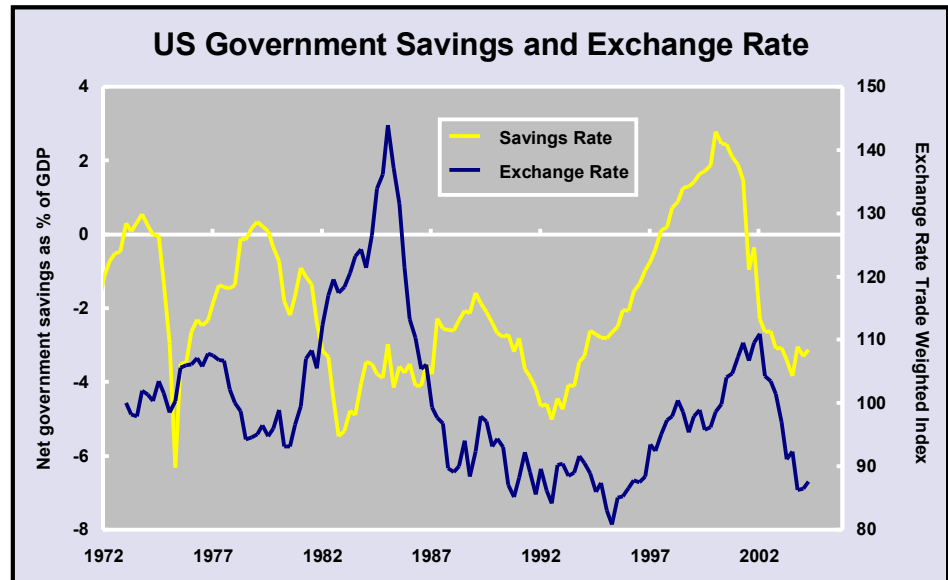
- It announces publicly each year its financial performance goals for the year ahead.
- It identifies explicitly how senior executive remuneration will be tied to the achievement of these specific goals.
- At the end of the year, the company presents a scorecard to shareholders, based on the previously announced goals, analysing its performance - showing both successes and failures.
- In highlighting where it might have fallen short, the company outlines why and unveils remedial action.
- At the same time, it publicly announces revised goals for the following year.
- Where these goals are different from those pursued in the prior year, it explains why that is appropriate.

All companies should comply with these simple, common-sense standards.

“...such an investor friendly approach would quickly be recognized for its honesty....the value of the company would appreciate.”

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THE WEEKLY CHART SPOT



Source: US Bureau of Economic Analysis

There is some anxiety being shown among commentators about the US budget deficit and how it might affect the value of the US dollar.

The US public sector deficit, equivalent to 3.1% of GDP at the end of the June quarter, is not unusually high by historical standards. The average deficit over the past 33 years has been 2%. There has been a deficit 80% of the time.

Over the same period, the average value of the US dollar against the currencies of its major trading partners averaged 100.2. At 87.6, the currency value is already significantly below its historical average.

There is little in the current deficit or exchange rate position to suggest an unusual combination of circumstances which might force the currency lower.

The future direction of savings will be important. Presently, official forecasts are for the Federal budget deficit to be reduced in coming years. Net private sector savings at 5.1% are currently running below their longer term average of 7.8% but have recovered from the cyclical low of 2.8% in December 2001.

Improved private sector savings have come from companies conserving their financial resources. Increased investment might cause a fall in the private savings rate. However, higher private sector investment will bring stronger growth and higher investment returns which would sustain confidence in the US dollar. ■

“Expect government senators, including members of the National Party, to use the forum of the coalition party room and party committees to extract concessions from party leaders in exchange for their support.”

THE ELECTION UPSHOT CONT'D

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outcomes for some of the reasons which have been discussed in earlier issues of *thebigpicture*.

The supremacy of the Reserve Bank in policy making means that the personalities heading the government or opposition mean less than they might once have done. It has been convenient for all politicians in Canberra to have foregone an involvement in setting interest rates.

Not having to be responsible for interest rate changes has removed a constraint on

their political activity and a new set of fiscal policy principles has emerged.

A surplus is mandatory. Everyone should commit to having one, no matter how wafer thin it might be.

That settled, spend whatever remains, no matter how strong the economy and the flow of revenues. If the economy weakens, reduce spending to avoid a deficit.

This pro-cyclical approach is precisely what the doctor of economics would not have ordered but it is the new policy prescription in Canberra. ■

INFLATION: HOW EVERYONE CAN HELP THE RBA

Policy makers, with their fingers on the interest rate trigger, keep being told by the inflation statistics that their anxieties are misplaced.

In the past week, updated inflation indicators were published in the USA and Australia. Both showed quite modest inflation pressures which belied oil prices touching near record levels.

In the USA, the private consumption expenditure deflator, regarded as the Fed's preferred inflation measure, was reported to have risen by 0.3% during the September quarter and by 2.1% over the year.

Without the petrol and food price components the quarterly rise was 0.2% and the yearly increase came to 1.4%.

Meanwhile, in Australia, the consumer price index rose by 0.4% in the September quarter to be 2.3% higher than a year earlier after a 12% hike in car fuel prices.

In both instances, inflation remained more or less within the bounds of what has been defined as acceptable by officials.

Admittedly, interest rate policy needs to be forward looking, but these results signal little cause for policy anxiety.

Corporate and individual behaviour might be saving the policy makers from some headaches. Prices are set by companies selling goods and services. If they are able to achieve acceptable levels of profitability while managing cost pressures, we should all be happy that the market based economic system is doing its job.

In Australia's case, for example, this was

not always possible. As long as there were tariff barriers and centralised wage arrangements, there were pressures and incentives for companies to pursue price rises as part of their business strategies.

Now, business managers know that they cannot rely on government or others to bail them out from the consequences of poor business decisions or to support their pricing targets.

Higher prices might lose them markets. Consumers know that they are able to switch to less expensive goods and are used to doing so in reaction to price changes. Similarly, employees prefer to absorb some of the pricing pressures rather than lose jobs by demanding higher wages to compensate.

The world has changed. Regrettably, among the groups learning about these changes most slowly are professional economists.

Ten years ago when interest rates were in the teens, they were forecasting reductions of perhaps a half percentage point. Subsequently, when rates actually more than halved, they began to look for the move up. They guessed far more rate rises than could be justified.

None of this is to say that we have permanently beaten the inflation problem. Thinking that might signal its re-emergence.

There is little doubt, however, that the competitive dynamics within the Australian economy have changed. The changes are allowing interest rates to be held at sustainably lower levels than they once would have been with a similar growth performance. ■

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THE AGM SEASON: LET BATTLE COMMENCE CONT'D

(Continued from page 1)

Investors have often seen catastrophic losses in the value of their shares while executives were behaving well within what the law required.

This is where investors need help. They need to be able to identify shortcomings in management skill much more quickly by directors being more open, honest and accountable in their public reporting.

A company committed to such an investor friendly approach would quickly be recognized for its honesty. Its candour would reduce investment risk and the value of

the company would appreciate.

For this to happen, there would have to be some attitude changes. For directors and management, saving face could no longer be a dominant influence on the way in which they communicate with the market.

Investors could then concentrate on the main game, namely, what sort of return is being generated on the funds they have subscribed. Do they meet the targets required? If not, what are the steps being taken to improve returns? Are the plans well enunciated and are deviations from plans well explained? ■

THE ELECTION UPSHOT

Senate manoeuvrings may become more intense after the election despite preoccupations about the new-found power of the Prime Minister. The Labor Party might actually be better off with a coalition majority in the Senate. Meanwhile, the Reserve Bank will continue to manage economic policy.

Some believe that having a majority in both houses has conferred unprecedented power on the Prime Minister. Do not take this for granted.

The slim senate majority for the coalition will deliver additional power to coalition senators which they have not experienced for more than two decades. Next year, we will begin to see how many are thinking individuals and how many are simply party ciphers.

When the coalition had a majority in the senate prior to 1980, it frequently had to negotiate with its own independently-minded senators who could not be counted on for support in all circumstances. Senators Wood and Wright were legendary for not allowing their leaders to take their votes for granted. Senator Misen was another.

Expect government senators, including members of the National Party, to use the forum of the coalition party room and party committees to extract concessions from party leaders in exchange for their support. This is likely to be particularly evident when the Telstra sale and media ownership rules come up for consideration. It could also happen in industrial relations if the government leadership tries anything too radical.

After July, the 39 coalition senators will have to take responsibility for legislation. If they believe it is inappropriate they will have to compromise their principles or oppose it. Not all of them but two or three at a time will be enough.

The challenge for the Prime Minister has changed. He knew who the Greens or Democrats were he had to deal with. From July, it could be any one of 39 individuals who could break ranks. The task will be

that much greater.

Another slightly offbeat thought is that the government Senate majority could be a blessing for the Labor Party. As long as the Senate was able to second guess the government, the Labor Party was drawn into policy making. This disadvantaged an opposition party, as some Democrats could attest.

Looking for compromise reduced scope for clear-cut differentiation. Not only did this hinder Labor when it needed to create obvious differences between itself and the government, it also highlighted the senate leadership when the leader in the House needed to establish his credentials with the electorate.

The minor parties, also given a national stage, usurped some of the natural profile of the major opposition party.

The GST debate is illustrative of the difference. When Paul Keating was Labor Party leader, he made it clear in the 1993 election that a vote for then Liberal leader John Hewson was a vote for the GST. The electorate would get a GST if Hewson was elected because the ALP would not move to block it in the Senate. This radical but tactically wise plan to confront the electorate with a definite choice helped keep Keating in power when many thought his defeat was inevitable.

Under Kim Beazley, in contrast, the ALP foreshadowed that its fight against the GST would continue after the election. A voter could support the coalition in the House but vote for the Labor Party in the second chamber to take the edge off less palatable policies, whether that was the GST, Telstra sale or industrial relations.

After July, when its Senate vote becomes redundant, the ALP will no longer have to be worried about negotiating compromises. It will be better able to emphatically state a position and stand against legislation in the knowledge that its vote will not make a difference. It will find it easier to define itself.

Meanwhile, the election will probably not have much effect on investment market

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