

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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AUSTRALIAN ELECTIONS: THE MARKET WINS

As in the USA, the Australian electoral cycle does appear to affect equity prices. Elections are good. The aftermath is not.

thebigpicture recently reviewed the impact of the US presidential election cycle on US equity prices. The analysis showed that over the past 55 years equity prices appreciated at an above average rate in the year of a presidential election. In the year after an election, the rate of appreciation was below average and the risk of a negative return higher than average.

The table summarises the performance of the Australian stock market around the 18 House of Representatives elections held in Australia since 1958. It shows changes in the All Ordinaries index in the 12 months leading up to an election and over the 12 months following an election.

Since 1958, the average 12 month rolling change in the Australian market indicator has been 9.0% compared with a 16.5% average gain over the 12 months approaching an election. Compared with an average 34% chance of a negative 12 month return, the chance of a negative return in the approach to the elections has been 18%.

Just as in the USA, the post-election market performance is significantly weaker. The average market appreciation in the 12 months after an election has been 6.5% with a 44% chance of a negative return.

None of this means that governments seek to manipulate equity prices deliberately. However, the sequence to government decision-making makes market friendly decisions more likely to be implemented in the approach to an election.

House of Representatives Elections Market Impact			
	1958-2004	12 mths prior to election	12 mths after election
Average 12 month rate of return	+9.0%	+16.5%	+6.5%
Chance of negative return	34%	18%	44%

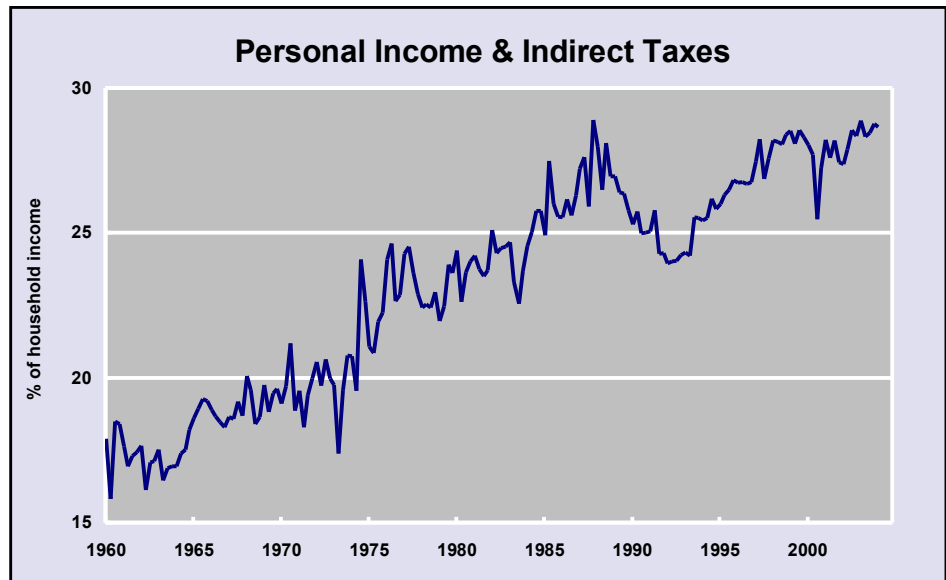
A new government is likely to begin its period in office by identifying the faults of the beaten party ensuring that changes with an adverse impact on the incomes of electors are implemented as quickly as possible – well ahead of the next election and within a time scale allowing any adverse repercussion to be associated with its predecessor.

Even a returning party will want to take hard decisions it put off before the election as quickly as it can while it is still at its most popular. Expenditure reductions or priority reappraisals where identifiable constituencies will lose income are the classic examples.

Electoral tacticians will usually want to implement policies favouring their parties' reelection so that electors can recall them when they go into the polling booth. This usually means they need to have an effect in the six to nine months leading up to the election itself. Unpopular governments will also want to deliver their electoral incentives over a similar time-scale.

Popular policies typically have a positive impact on disposable incomes; unpopular ones the reverse. The economic multiplier effects will typically also have an effect on rates of economic activity and company profits. Hence, good markets in the approach to an election and relatively poorly performing markets in the year afterwards. ■

THE WEEKLY CHART SPOT



Source: Australian Bureau of Statistics and *thebigpicture* calculations

The burden of direct and indirect taxes is again edging up ominously just as it has been rising with few points of resistance for most of the past 45 years. A significant recession such as we had around 1990 can bring some relief (but at what cost?). The changes associated with the GST introduction – the greatest tax change the country had seen – stalled the trend only briefly.

‘OPPORTUNISM’ IS NOT A DIRTY WORD

Opportunism is to be condemned. So say companies being subjected to public bids. Shareholders should actually demand more opportunism and reward it handsomely.

The directors of Australian Leisure and Hospitality, the pubs and gaming business floated by Foster’s Group eight months ago, are the latest to label a public bid for shares as “opportunistic” as they reject it on behalf of their shareholders.

Whatever the true value of a target company, there is always a chance that the bidder will give up a little more. It is not unusual, therefore, for target directors to suggest, as an opening gambit, that an initial bid undervalues their business.

A reference to ‘opportunism’ in this context is supposed to be bad. In so describing a company’s conduct, directors seek to stigmatise a bidder as behaving somehow improperly.

The bidder is at an immediate disadvantage, in any case. Even for companies which have long languished ignored and undervalued by the market, a bid brings life and the market conspires to extract as much value from the bidder as possible.

Speculators – sometimes referred to more elegantly as arbitrageurs – buy in anticipation of a higher bid emerging. Analysts publish valuations to show that there is previously unheralded value to be had. Managements begin to outline value en-

hancing plans which, strangely, had been kept under wraps before the bid was announced. Advisers argue that the target shareholders are entitled to at least a part of the synergy benefits to be extracted by the bidder’s management. Valuation experts can usually be found to validate a higher share price than had been prevailing especially after a 30% premium for control is applied.

The price is pushed toward the level (and perhaps past it) at which there is no incremental value for the bidder.

At that point, the wise director will elect to walk away from the bidding process. After all, at this point, by definition, there is nothing in it for his shareholders. And yet the investment in time, money and ego is considerable.

In launching a bid, a key part of the corporate strategy has been revealed. It is often preferable in the minds of managers to buy something too expensively than fail to execute and then have to answer questions about ‘plan B’ and why it is not failure. They will be tempted to spend too much.

This is the shareholders’ nightmare. They might spend the next several years dealing with the repercussions through share price underperformance and asset value write-downs.

Shareholders in a bidding company should

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THE DISAPPEARING FAMILY CONT'D

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other of the alternative family structures. The situation of older people without children, the newly emerging family unit of significance, is being addressed similarly.

Overall, family structure is being de-emphasised as a policy target. The implied government commitment is to deal with the consequences of the structural changes underway rather than affect the underlying trends.

Looked at from an economic perspective, there used to be economies of scale in having two parents look after more than one child and combine their resources to run a household. Similarly, there were efficiencies from children looking after their aged parents. The ABS statistics flag that neither of these alternatives will be available to the extent that they were.

Not only will the personal resource commitment be limited, the capacity of governments to take up the slack will also be constrained. With a broad commitment to maintain surplus budgeting, already less is being spent than raised in revenue.

A major challenge for governments will be how they provide a range of services which families are no longer organised to provide. However, there is no magic pudding. The community will come to realise that there was economic value in keeping the traditional family units together.

Outsourcing to the government the services which the old family unit used to provide incurs a cost which will have to be met from elsewhere and that will normally mean an added financial burden for the newly-defined family.

Income taxes, expenditure taxes and user levies all have an adverse impact on household disposable income. Company taxes, accounting for some 20% of re-

ported revenue at the Commonwealth level, are levied on company profits initially. However, they also eventually have an impact on family living standards by raising the prices to be paid for goods or services.

By far the majority of the \$227 billion² in tax to be raised by the Australian government in 2004/05 will come from household income either directly or indirectly from taxes embedded in prices.

According to the most recent national accounts data, personal income taxes accounted for 14.2% of household income. Other taxes such as those on expenditure or production which are typically passed through to the consumer were equivalent to another 14.5% of household income.

The family support measures contained in the budget, for example, simply return a portion of pre-tax disposable incomes raised from households in the first instance, and quite a small proportion at that. The \$19.2 billion in additional outlays to be spread over five years will be equivalent to just 0.6% of current household income.

Australian governments already return to households the equivalent of 11% of household income as social benefits. Governments provide many services in addition to direct payments supplementing household incomes. These indirect benefits might be efficient ways to supplement household welfare in many circumstances.

Nonetheless, as governments feel compelled to substitute more robust safety nets, the household tax burden is likely to rise further, too. The near record 29% of household income currently being taken in tax is likely to be exceeded in successive years as the limited options for government become more apparent. ■

"In all three scenarios... the proportion of families made up of couples with children falls and the proportion of single parent families or families without any children rises."

'OPPORTUNISM' IS NOT A DIRTY WORD CONT'D

(Continued from page 2)

want it to underpay for assets. Value is only going to be added when assets are mis-priced long enough for advantage to be taken. Shareholders should reward managers for their opportunism and encourage its proliferation.

Opportunism should then be taken one step further. When the bidding process takes prices beyond the point at which value can be extracted, companies should

say that they are not interested in going any higher.

They should leave target directors to extract the extra value they had lately identified. They should announce proudly that they are being purposefully opportunistic in not going higher. And their shareholders, recognising their contribution to the well being of the company, should be grateful for them embracing opportunism as a management tool. ■

2. Including the proceeds of the GST which the Australian government does not include in its budget accounts.

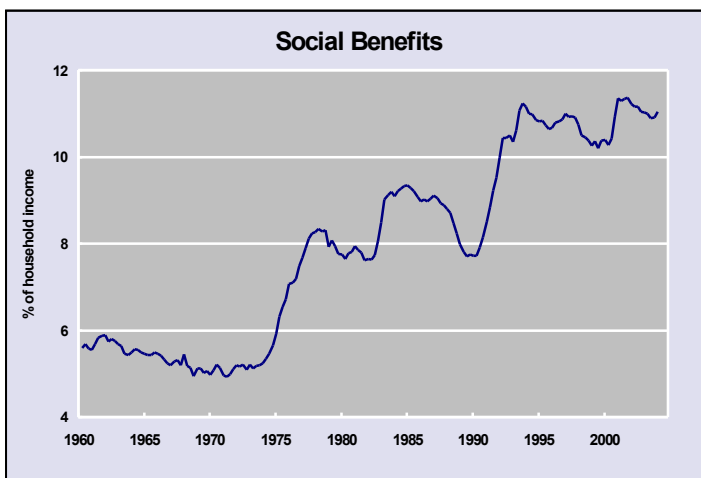
THE DISAPPEARING FAMILY

Continuing structural changes gnawing at the 'two parents and children' family model will burden governments and eventually impose a larger financial obligation on all households.

On 18 June, the Australian Bureau of Statistics (ABS) published¹ its review of what constitutes a family, at least statistically, and how family structures could change over the coming 20 years.

For the ABS, a family covers most modern eventualities. It includes "two or more persons, one of whom is at least 15 years of age, who are related by blood, marriage (registered or de facto), adoption, step or fostering, and who are usually resident in the same household".

The number of families in Australia is pro-



jected by the ABS to increase from 5.3 million in 2001 to between 6.8 million and 7.1 million in 2026. The range in the projection reflects three different scenarios about living arrangement propensities – whether rates of change since the 1986 census continue, whether they begin to moderate or whether there are no further changes from this point.

Under the first of the scenarios, future changes are the most radical. In the third, the variation from the current state is least. The ABS offers no conclusion as to which of the three alternatives is the most likely. In all three scenarios, however, the proportion of families made up of couples with children falls and the proportion of

single parent families or families without any children rises.

With an expected drop in the number of children up to the age of 14 in the population from 4.0 million in 2001 to 3.8 million in 2026 and the average age of the population set to rise from 35 to 41, further structural changes to the nature of the family unit were inevitable.

Of all family types, the number of couple families without children is projected to increase most rapidly, by between 54% and 73% depending on which of the three assumptions is used.

If the rate of change of living arrangements since the 1986 census is maintained, the proportion of two parent families with children will fall from 46.6% of all families in 2001 to 29.5% in 2026. In this scenario, the proportion of childless families will account for nearly half (48.6%) of all family units.

The ABS estimates that as few as 66% of the lower number of children could be members of a two parent family grouping.

Despite the Australian Treasurer's proclamation that the family was "front and centre" in the budget he presented in May,

family policies with general applicability will become harder to achieve faced with the increasingly diverse nature of family groupings. Politically, it will be harder for governments to discriminate between family styles as what has been 'normal' is recast without any dominant alternative being substituted.

There is already some evidence, from the way in which governments of all complexions have been making policy, about how they will react. The emerging model is to use policy as a safety net. The implicit aim is to ensure that children are not obviously disadvantaged by being in one or

"The community will come to realise that there was economic value in keeping the traditional family units together. Outsourcing to the government the services which the old family unit used to provide incurs a cost which will have to be met"

1. Household and Family Projections, Australia, 2001 to 2026, Australian Bureau of Statistics, ABS Catalogue no. 3236.0, 18 June 2004.

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