

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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HOW MUCH DO CEOs KNOW?

Corporate chief executives around the world have become more bullish about prospective economic conditions at the same time as professional macroeconomic forecasters are expecting some slowing in growth. The corporate view might simply be reflecting the circumstances prevailing when the survey was undertaken. If not, conditions might be more buoyant than the formal forecasts suggest.

PricewaterhouseCoopers (PWC), the international accounting and business services firm, has surveyed 1,324 chief executives from around the world to gauge their views about a range of economic and business topics as a prelude to the Davos Economic Forum of which the firm is a sponsor. This is the eighth year that PWC has conducted the survey. Interviews occurred in the fourth quarter of 2004.

The survey sought the views of CEOs across the principal geographic regions of the world and across a broad spectrum of companies defined in terms of size and industry sectors.

Most questions in the latest survey dealt with governance, risk management and compliance, seeking to understand how companies are coping in a world where these matters feature more prominently among stakeholders judging performance. However, as usual, there were several questions about the economic environment and how that might affect business conditions.

The survey is worth noting because it suggests that this broad expanse of business executives is significantly more optimistic about business conditions than they had been in prior years. For example, 41% of respondents were "very confident" about prospects for revenue growth within their companies compared with 26% in the equivalent survey two years earlier. Ninety-one percent of respondents were "very confident" or "somewhat confident" compared with 72% in 2002.

Perceptions about external threats to business outcomes had changed little. Taken with the greater confidence about likely business performance, the results suggest executives are better able to work within what had once been perceived as more serious constraints on their activities.

There was a change in the view about terrorism. The possibility of international terrorism activity seems to have diminished in the minds of the executives. Terrorism ranks fifth among potential threats to business growth after overregulation, increased competition, loss of key talent and reputational risk. And a larger proportion of respondents identified it as no threat or a minor threat than did so in 2003.

Of course, the mere fact that executives might be less concerned about terrorism does not say anything about its likelihood. Memories are dimmed by the passage of time. Despite a generally heightened sense of concern, the absence of further large-scale violence in western cities is likely to have created some sentiment among business people that they should get on with the job rather than modify plans in anticipation of another attack.

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HOW MUCH DO CEOs KNOW? CONT'D

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For other companies, the macroeconomic view is irrelevant. Even assuming that they had some particular insight into likely changes in the broader business environment, changing strategy might be unwise.

Assume a company knew, for example, that economic growth was going to slow. Would that lead it to cut back production in anticipation? Probably not. The risk of doing so, including the potential disruption to customer relationships, would be too great.

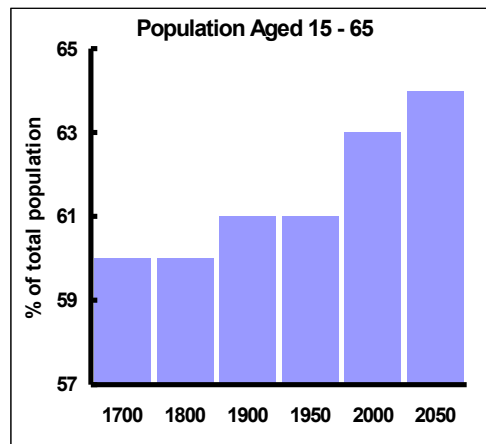
Most managers would prefer to keep people focused on selling more and reducing costs. These are the variables that are more directly under the control of business operators. Even suggesting that these outcomes can be disrupted by outside changes risks offering staff an excuse for not trying as hard as they should.

So it is always a little problematic asking CEOs their view of the world. The answer you get might not be the inferences they are drawing from their own businesses but simply the views they are getting from others, albeit modified at the edges by some of their own experiences and viewpoints. Sometimes, they are sending messages to their staff rather than offering objective analysis.

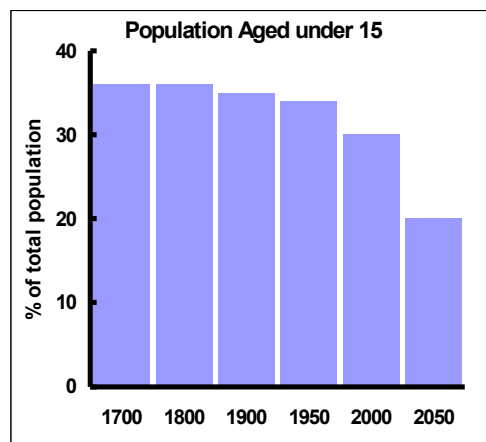
Chief executives, too, are subject to the affliction of all forecasters: when asked for a forecast, extrapolating current conditions into the future and, therefore, frequently missing important turning points or changes in the pace of growth. And, of course, these momentum changes are critically important in driving investment market outcomes. ■

THE DEMOGRAPHIC PICTURE SHOW CONT'D

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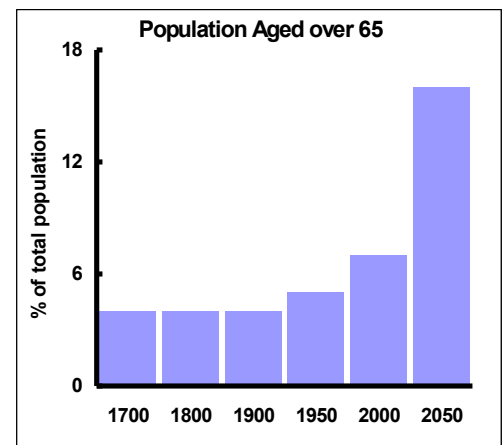


The proportion of the population in the key 15-65 working age group is expected to rise very slightly - by a single percentage



point - over the coming five decades as a result of these other factors. The big difference is that the proportion of the population over 65 years of age is set to more than double.

The number of working age people for each person over the age of 65 will fall from over 12 in 1950 to around 4 in 2050.



This is the big policy issue. How can a working population which is little changed service the needs of this much larger group without greatly diminishing the standards of living it might have come to expect based on the lifestyles of the previous generation? ■

HOW MUCH DO CEOs KNOW? CONT'D

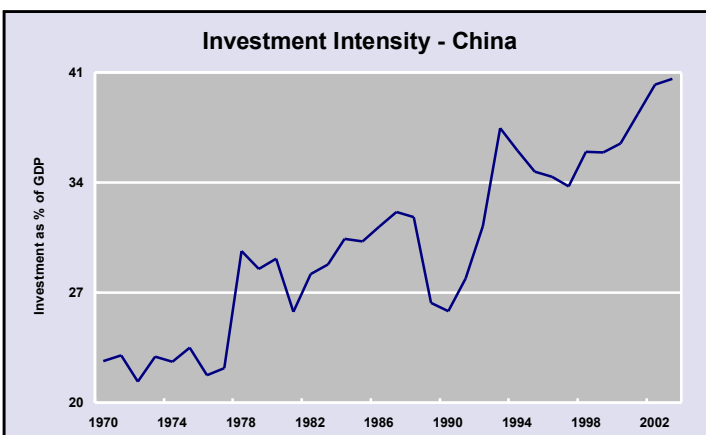
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Interestingly, Tom Ridge, the retiring US Homeland Security Secretary was reported in the past week as saying that another terrorist attack on the USA was not just a possibility but inevitable.

Against this background, a lesser concern about terrorism by businessmen might simply mean that (when it occurs) a terrorism act has the potential to force a significant change in business behaviour.

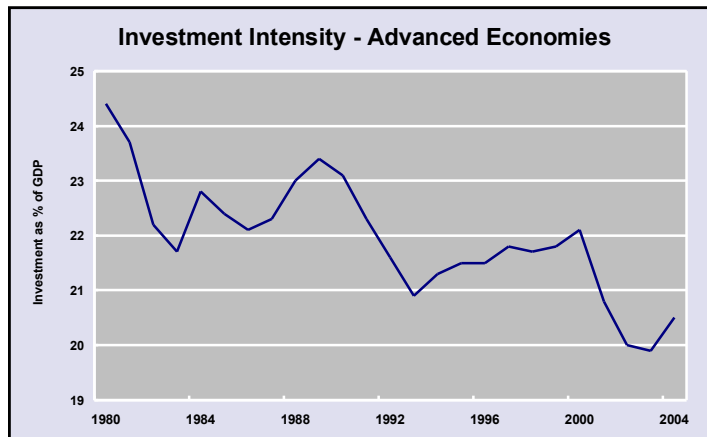
Executives may well be preoccupied with other risk factors, such as government regulation, on a day-to-day basis and rate them more significant in terms of their daily impact. While regulation is a heavy burden in some industries, overnight changes in regulatory conditions are unlikely to cause a dramatic reappraisal of how business should be conducted.

From an investment market perspective, therefore, the threat of terrorism on the US mainland probably remains the largest single threat to business performance (and, therefore, the continuation of sustainable economic growth) because its shock value can force a dramatic and unanticipated change in outcomes.



Capital spending is on the increase among the companies surveyed. Sixty-one percent of executives foreshadowed increased capital investment. This indicator of intent may be significant. Globally, capital spending by business has been below the historical performance.

In the USA, investment spending relative to corporate cash flow has been exceptionally weak in recent years and investment spending among the advanced economies as a whole has been retarded by economic



weakness in Japan and Europe. Only in China has business investment spending been conspicuously strong.

Signs that global capital spending by business is on the rise are, therefore, especially significant since they throw some doubt on the widely held view of economic forecasters that growth is likely to decelerate in 2005.

Perhaps only time will tell because business executives might not be well suited to make judgements about prospective conditions. Their businesses are as forward-looking as their customers permit. In the 'just in time' era, forward warning of a change in conditions might have been rendered implausible.

We all expect CEOs to have some insights into the business environments in which their companies operate. Hence the survey. However, that is not always the case.

Many companies that once had people tracking the state of the world as an input into planning processes have foregone the luxury and outsourced such analytical functions. To that extent, company views of the macro-economic environment are now simply the purchased views of others.

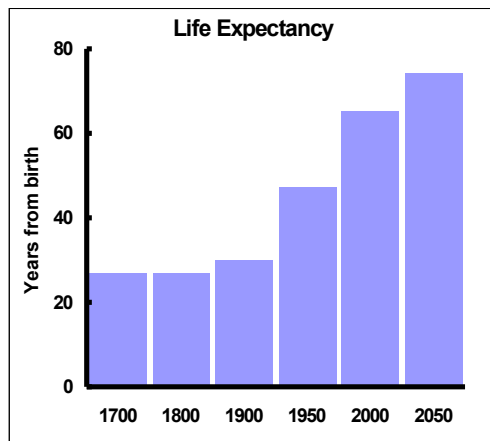
“The possibility of international terrorism activity seems to have diminished in the minds of the executives. Terrorism ranks fifth among potential threats to business growth after overregulation, increased competition, loss of key talent and reputational risk.”

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THE DEMOGRAPHIC PICTURE SHOW

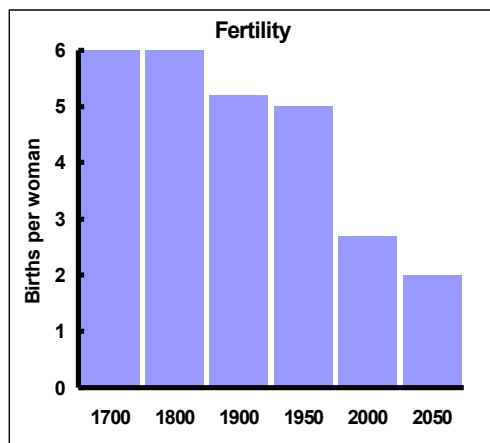
This issue of *thebigpicture* depicts in a series of charts sourced from United Nations and International Monetary Fund data the long term influences likely to lead to some of the most momentous economic and financial changes in 300 years.

The changing demographic environment has been much discussed in the context of an aging population and the implications of that for funding government ser-



vices. Even before the most dramatic of the changes had begun to occur, however, retirement incomes and health care were being put on the public policy agenda through the political sway of a growing number of older people.

At the same time, parts of the health care budget were beginning to cost more quite independent of underlying demographic changes as more advanced technology

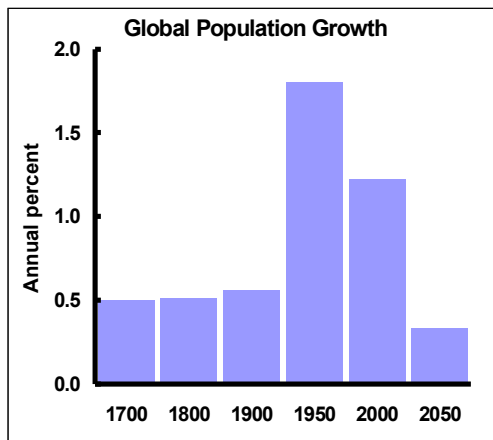


and medical science were being brought to bear on existing health issues.

Average life expectancy more than doubled through the twentieth century. Rapid improvement in community health standards, international co-ordination of efforts to prevent disease and the reduced incidence of warfare, notwithstanding two global wars, all helped.

There is some debate about whether life expectancy rates can go on increasing indefinitely or whether there is a practical limit to how long a human being can live. Nonetheless, further improvements are expected by official agencies.

Fertility rates halved during the twentieth century. More suitable conditions for childbirth leading to more children surviving, rising living standards, the changing aspirations of women, financial pressure



on women to work and the reduced economic value of children all had an impact. A further fall expected during the coming 45 years will take global population to the brink of barely replacing itself.

This snapshot of 300 years of history now shows how aberrant the second half of the twentieth century was as a period of population expansion. With population growth prospectively one quarter of what it had been, underlying rates of economic activity are likely to be detrimentally affected forcing a reappraisal, among other things, of investment returns.

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