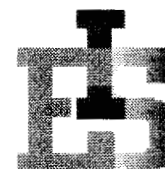


THE INDICATOR

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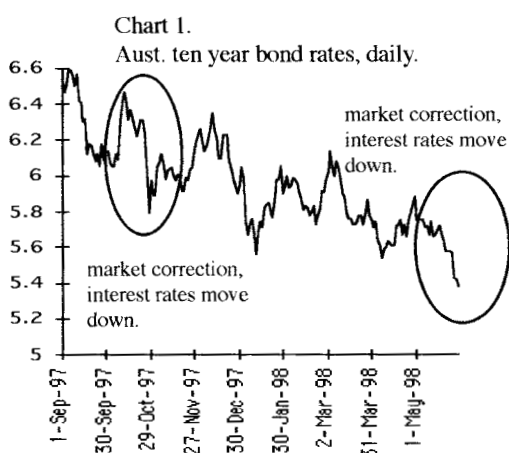
ECONOMIC INDICATOR SERVICES



The flight (once again) to Bonds.

This month we have written a special (extra) edition of the Indicator. Normally 6 per year but there occurred some important events last week, which we wanted to highlight.

Stock markets, in particular Australia's, are currently retracing off April highs. What is so significant about this is that the correction to our market is occurring



whilst interest rates, as expressed in 10 year bonds, are trending down, not up. During last October's stock market correction, there was also a flight to bonds, or "flight to safety". Professional investors and market players moving money to the bond market, buying bonds. In a deflationary environment, that is precisely where the big money goes. It is important to notice.

It is telling us that the big money believes the deflationary trend, of lower prices, increased use of technology, and lower commodity prices lowering even further the cost of manufactured items, is set to continue.

Never be highly geared under such conditions. When prices are declining, and interest rates are coming down, debts can become much harder to pay off. This is not noticed whilst the decade business cycle is moving from recession to boom. But once the cycle turns from boom to

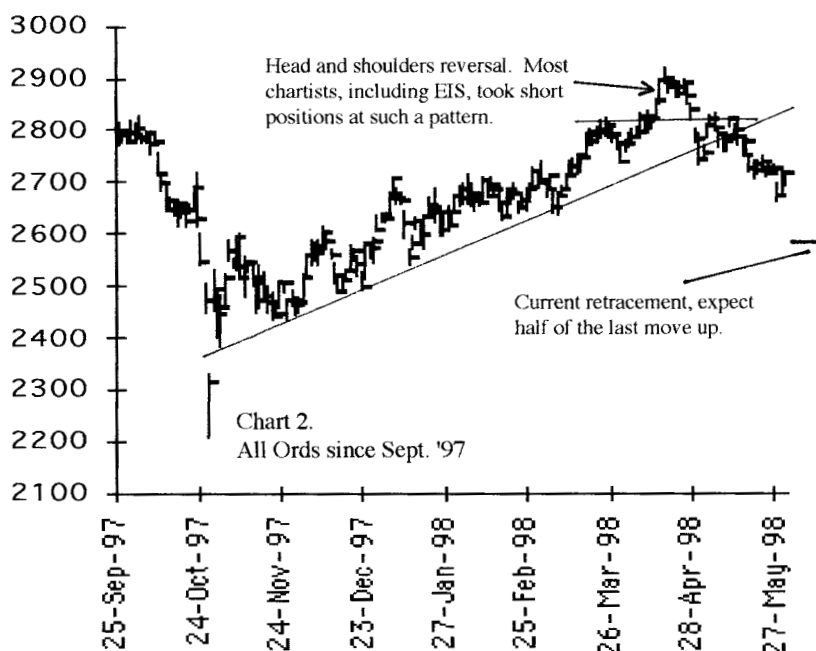
bust, as they all do, then gearing can prove a problem, as official interest rates are slow to adjust to the new set of deflationary circumstances, and remain too long at high real levels. As they are at the moment. During the 1980's interest rates averaged 3% above inflation. So far this decade, interest rates have averaged 5% above inflation. One of two things must continue, either inflation goes up, or interest rates come down. The markets have the money on interest rates.

A forecast for our stock market.

Our market is currently retracing its move up from October to April. This is normal market behaviour, and a move down to 2550, half of the move up, can be expected. The move down in May is occurring as we forecast in the April Indicator. Further bad news will drive this retracement into June.

Observe how it is much less comfortable to buy stocks today, than it felt in March and April, yet stock prices are now cheaper.

From mid June EIS expects the market to resume its up trend. We anticipate history to repeat, therefore expect on the upside, a similar move as occurred last time, October to April, added to the eventual June low. From a charting point of view though, the market must hold the 2500 level, and should not fall below this point. A retracement so described needs to occur, for any market to continue to rise strongly.



Price pressurés continue.

National Mutual's most recent half year report revealed a profit drop of 18% to \$144 million. Significantly though, operating earnings rose 88% as the company "continued to strip expenses out of the business". 800 of those expense items being jobs. Bad news for labour, good news for shareholders.

More important to inflation levels however is what they have planned; National Mutual intends to further cut costs by 14% over last years figures, by further cutting base management expenses. A commitment to achieving more than \$100 million in savings over the next three years.

This strategy typifies what large corporations all round the world are doing, using technology to cut costs, adding to the deflationary pressures.

The US company General Electric is another recent example of the relentless pressure on prices. The company's lighting division, in 1996, commenced its on-line procurement system. Since then, labour costs have dropped in excess of 30%. A further 60% of the procurement staff have been redeployed and GE reported that their sourcing department gained six to eight additional days a month for strategic activities, rather than the old work of photocopying, envelope stuffing and general office paperwork required when the process was more manual.

General Electric's material costs have dropped 20% as the ability to reach a wider base of suppliers on-line created more competition and led to lower prices. (AFR, 24th April 1998). Information technology continues to apply pricing pressures. One company, in just one business function, cutting costs by half.

Asia also continues to exert pricing pressures. Korean car company Daewoo, hit hard by the crisis reports it is now fighting back through increasing exports, forming new strategic alliances, and cutting costs. It means cheaper cars.

Government monopolies continue to fall. The Queensland government has now introduced competition on its former monopoly coal hauling operations. It means lower prices for large Queensland based coal miners.

Likewise, recent accountancy company surveys reveal that over one quarter of large electricity users surveyed had achieved power cost savings of 40% or more since deregulation. On a \$4 million power bill, this is quite a saving.

The pricing pressures mentioned above are strong enough to absorb this decade cycle's usual wage and asset price rises. Watch out when the business cycle turns down.

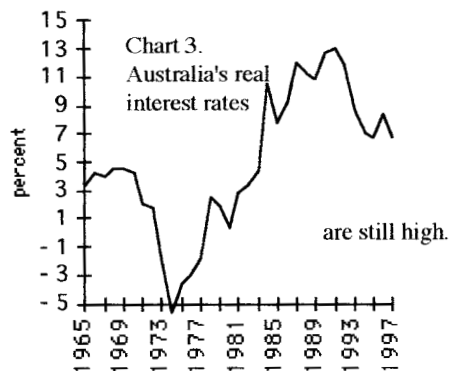


Chart 3 measures Australia's bank overdraft rate, minus the inflation rate. Observe that in the early 1970's the real interest rate went negative, ie inflation was higher than interest rates. A time to borrow as much as you could.

In the last few years, the real cost of money has never been higher. Not the time to be highly geared. It is more cost effective to pay down debts.

We remind subscribers that in a deflationary decade, interest rates are not a reliable indicator of the business cycle position. Few economists will pick this.

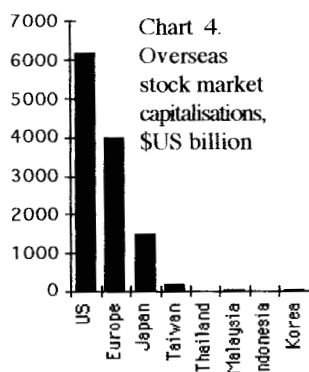


Chart 4 reveals just how big the American stock market really is. It is when the US business cycle turns, that deflationary pressures could really be felt. This requires close monitoring by investors.

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Cycles analyst: Phil Anderson
Marketing and technical analyst: David Rasmus

247 Flinders Lane
Melbourne 3000
Phone: (03) 9650 3155
mobile: 015 314 405
Fax: (03) 9650 8642
Email: phil@glasswings.com.au

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