THE INDICATOR

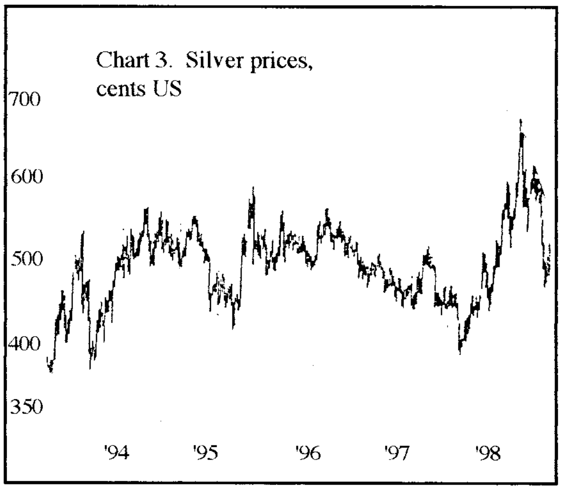
Oct 1998 Insert #1

Warren Buffett feature ECONOMIC INDICATOR SERVICES

Buffett's Silver Venture Was No Folly.

Warren Buffett, the so called Oracle from Omaha, this year bought one fifth of the worlds silver supply. EIS found this curious. In fact we found it downright dumb, given the unfolding scenario of deflation, and commodity price lows likely within the Kondratieff wave trough for 1999, that EIS has been forecasting since 1995. So we commissioned our Political Risk Analyst, Graham E. L. Holton, to do some sleuthing. He reports:

"When Warren Buffett announced in February 1998 that he had purchased 129.7 million ounces of silver over the previous seven months, 20% of the world's estimated annual supply, silver rose by 25% to a 9 1/2 year high. But investors continued to wonder why the canny Chairman of Berkshire Hathaway, America's most famous investor worth an estimated US $16.6 billion, had made such a move given the disastrous consequences of the Hunt brothers who lost US $2 billion in the late 1980s on attempting to corner the silver market.



Silver is usually known as a precious metal, but it is also a very important strategic metal; the new technology of the 21st century will consume ever increasing volumes of silver.

In July 1998 the U.S. Department of Energy report '*At the Frontiers of Science: Superconductivity and its Electric Power Applications*' announced that a collaborative agreement with several industrial and electricity utility companies costing up to US $47 million had been made to construct High Temperature Superconductor (HTS) cable to power several facilities owned by Southwire Company, the largest cable maker in America.

These HTS wires use silver as a sheath, as it does not react with superconductor powders and is highly electrically conductive, carrying up to five times more current than conventional copper wires. The Chairman of Intermagnetics, Carl Rosner, says that 'So far, silver is the only material that prevents deterioration of the superconducting properties'.

Once the tests are successful the new HTS cables could replace the transmission line grid in the United States, using as much as 1000 kilograms of silver per kilometre. If one includes the application of incorporating HTS technology, the entire U.S. market for superconductor products and services could cost US $200 billion by 2020, with an annual consumption of 30 million ounces of silver, especially as U.S. electricity demand is expected to double by 2030.

Silver will also have greater application to U.S. military systems and satellites.

Silver oxide-zinc batteries, called 'button cells' provide 40 watt-hours per pound compared to 14 watt-hours per pound for nickel-cadmium systems. In 1997 1.2 billion button cells were sold worldwide. These batteries have an increasing use in specific requirements of spacecraft, space shuttles, satellites, missiles, rockets, torpedoes and life support systems. Astronauts use these batteries in their space suits and power tools because of their reliability.

Military vehicles with all-electric propulsion systems are powered by rechargeable silver-zinc batteries. Since silver chloride-magnesium batteries are activated when immersed in sea water they have primary military applications.

Silver paste is used in 90% of all crystalline silicon photovoltaic cells which are the most common solar cells. Silicon cells used to power satellites use silver in the form of evaporated metal to make electrical contact. The U.S. consumes 4.2 million ounces of silver to manufacture batteries, while Japan consumes 2.0 million ounces annually.

Over 60% of annual silver production is consumed in industrial uses and photography. According to the

Silver Institute demand for silver exceeded mine production in recent years by 104 million ounces, depleting above-ground stocks, while low silver prices has forced a number of mines to shut down production.

According to the commodity analyst, George Kleinman, the COMEX division of the New York Mercantile Exchange warehouse stocks of silver were down to 110 million ounces in February 1998, then a record low.

In July silver prices broke through a key price barrier as declining stocks fuelled speculation of dwindling supplies, when COMEX stocks fell to 83 million ounces. If recent silver futures prices are any indication, silver will see rises in the near future.

According to Bernie Savaiko, an analyst at Paine Webber, 'Silver seems to be the special situation among the precious metals".

Graham E. L. Holton,

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Thanks Graham. Now Buffett is not the only investor interested silver. One of the leading companies in the North American silver sector is Apex Silver Mines Limited.

This company is rumoured to be attempting to build one of the largest, and most diversified group of silver properties ever put together. Significantly its silver reserves are now the largest in North America. One of its mines, in Bolivia, could develop into the largest silver mine in the world, though that is only speculation at present. The Bolivian mine is not expected to start up until 2002.

Apex Silver Mines has just 19 million issued shares, 20% of which is owned by none other than George Soros' Quantum fund. Another 60% is owned by company officers, Directors, and one Louis Bacon, another hedge fund operator. This is a tight share registry, in a company worth watching.

Finally, two further points about Buffett.

His holding company, Berkshire Hathaway, purchased the huge American reinsurance company General Re. So what ? General Re has an enormous bond portfolio of about US $19 to $20 billion. The purchase therefore reduced Berkshire's proportionate stock market holdings by one fifth. Precisely the right thing to do, at this time in the decade cycle. His timing was June. The US market peak, (so far), was July.

And as has been noted in most newspapers, Berkshire Hathaway's holdings of cash this month are the largest that has ever been recorded by them on a dollar basis, though when measured on a proportionate basis to assets held, cash held has at other times been more significant.

Feel tempted to buy a few shares in Berkshire hathaway ? Just one share will set you back a cool $65 000 at current prices.

Hi ho silver and away !

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THE INDICATOR

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U.S. and Japan comment

ECONOMIC INDICATOR SERVICES

What's happening in America ?

The run up in the US stock market this decade has been quite amazing. Is it sustainable ?

The rise in the market has been built, partially at least, on some very productive advances in new technology. This is creating some real wealth, and lots of jobs. Very different to the 1980's.

US high tech companies are leading the charge. Companies like:

~ Cisco Systems Inc. Cisco's latest manufacturing effort is 'optical internetworking' to help increase bandwidth efficiency with reduced costs and complexity.

~ Lucent Technologies Inc. Lucent is a manufacturer of data voice and video networking equipment and telecommunications systems.

~ Sprint, which has developed its Integrated On Demand Network (ION) to allow your household or business to receive faxes, send/receive multiple phone calls and use the internet at more than 100 times faster than present connection speeds, all at once, through just a single connection.

~ Ciena Corp, a manufacturer of telephony equipment to help long distance phone carriers extend their fibre optic cable capacity.

Note these companies are manufacturers. They are actually building the next information medium, the new industrial revolution. Building it with them are even bigger companies like, Dell, Compaq, IBM, Microsoft, Intel, Netscape, Motorola.

Do not underestimate what this new information technology is about to do to the way you conduct business. It will be revolutionary. But just as with past history, share markets get ahead of themselves, usually in a speculative bubble, as investors 'anticipate' the future gains far too soon.

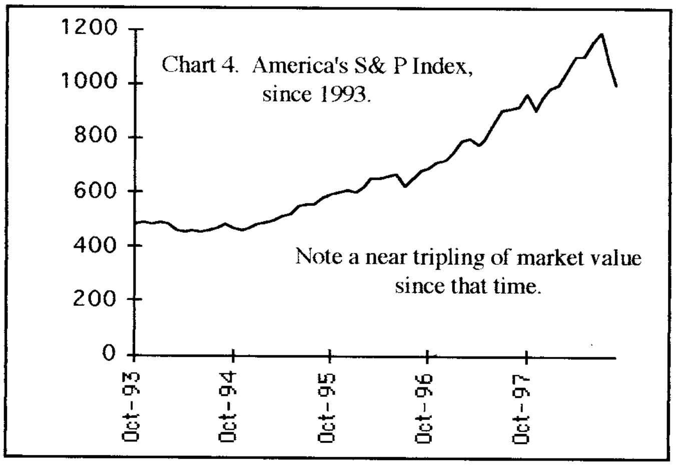
This is history repeating. In the 1860's railroad stocks were the rage, telephone / autos in the 1910's, air and radio stocks in the 1920's and so on.

In 1998 the speculative frenzy found an outlet in internet technology; America Online, Amazon, Excite, Lycos, Yahoo (p/e ratio 435), Qwest and others. A reliable sign of a major top in the making. A top that will later not be exceeded for some years. And similar to the previous eras mentioned above, the top 25 internet related US companies presently have a total market capitalisation of around $US 30 billion, 80% of which have yet to make a profit.

Market bubbles always burst; sometimes with a crash, but not always. And this one will be no exception. For investors, it can make for nervous times. But we urge being mindful of the bigger picture.

First, market declines mean a drop in price, not value. Look for value amidst the price carnage.

Second, the US is leading the world into the 21st century technological revolution that will be as great, if not greater than the Industrial revolution of the 19th Century. It will bring great prosperity to a lot of people, as did the Industrial revolution. But there are



the inevitable adjustment processes along the way.

A slowdown in the process in 1999, from a bursting 1998 speculative bubble, EIS sees now as absolutely certain. Our reasons for this opinion are highlighted in the other sections. We have been saying since 1995 that this decade cycle would end in deflation, forecast then at around the year 2000. We are not forecasting a depression, but 1999 will be exceedingly difficult for nations / corporations individuals with excess debt.

But the bigger picture of deep structural economic changes currently taking place, leading to a very productive first decade of the 21st century will eventually win out. Be prepared.

This will make redundant, the 20th century style organisational set up, like BHP for instance; monolithic, slow to respond to change, and not a market leader in any one core activity.

Note that America's largest stock market sector is the technology sector, where a huge number of jobs are being created. Our largest market sector is banking, where a huge number of jobs are being lost.

We attach what one of our leading tech stock's (JNA) CEO had to say, as yet another US company bought out our largest remaining telecommunications technology manufacturer, and their best engineers, and carted them back to the States. Our current crop of politicians, on both sides of the house, are yesterday's men in our view. Especially going for a GST, a tax that the Internet will make redundant, or require heavy policing to enforce.

Finally, we highlight some interesting historical parallels for your interest.

1. On August 4th Bloomberg news (website) reported the following;
"*Ralph Acampora, Prudential Securities Inc's widely followed market strategist,* (and technical analyst) *said the Dow average may decline as much as 20% from its highs. 'After being bullish for three and a half years, I'm in the bear camp, said Acampora, who in March forecast the Dow average would reach 10000 this year. Acampora said he now expects the stalled economies of Asia to continue to depress profits of US companies. A 20% drop from the Dow's July 17 record would take it to 7470.*" Which is of course exactly where it went.

Here's what J K Galbraith said about 1929, from his book "*The Great Crash, 1929*", Penguin books, 1984 Ed.

Page 108, "On 3 September, by common consent, the bull market of the nineteen-twenties came to an end. Economics, as always, vouchsafes us few dramatic turning points. Its events are invariably fuzzy or even indeterminate.

On some days that followed - a few only - some averages were actually higher. However, never again did the market manifest its old confidence. The later peaks were not peaks but brief interruptions of a downward trend.

On 4 September, the tone of the market was still good, and the on 5 September came a break. The Times industrials dropped 10 points, and many individual stocks much more. The blue chips held up fairly well, although Steel went from 255 to 246, while Westinghouse lost 7 points and Tel and Tel 6. Volume mounted sharply as people sought to unload, and 5,565,280 shares were traded on the New York Stock Exchange.

The immediate cause of the break was clear - and interesting. Speaking before his Annual National Business Conference on 5 September, Roger Babson observed, "Sooner or later a crash is coming, and it may be terrific." He suggested that what had happened in Florida would now happen in Wall Street, and with customary precision stated that the (Dow Jones) market averages would probably drop 60 - 80 points. In a burst of cheer he concluded that "factories will shut down... men will be thrown out of work... the vicious circle will get in full swing and result will be a serious business depression."

This was not exactly reassuring. Yet it was a problem why the market suddenly should pay attention to Babson. As many hastened to say, he made many predictions before, and they had not affected prices much one way or another. Moreover, Babson was not a man who inspired confidence as a prophet in the manner of Irving Fisher or the Harvard Economics Society. As an educator, philosopher, theologian,

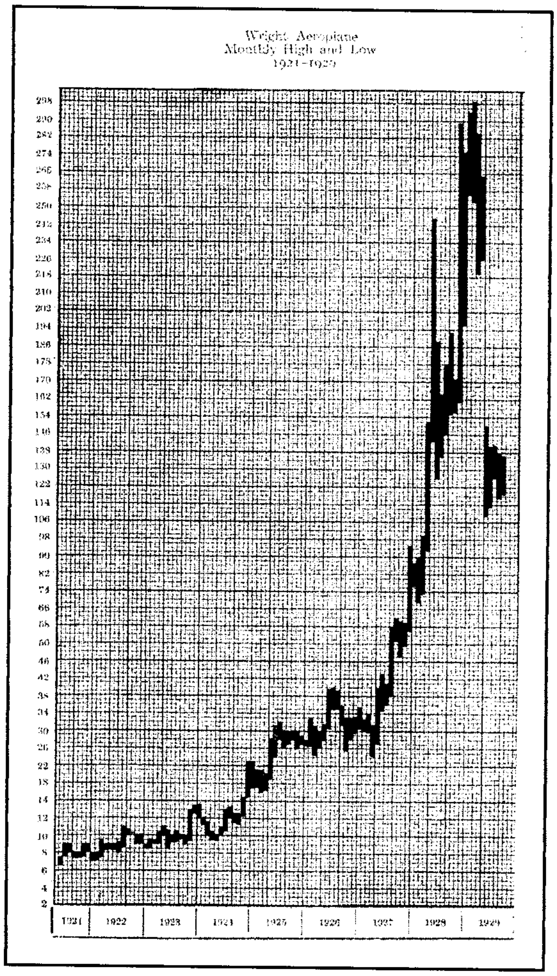


Fig. 1. Chart of Wright Aeroplane, from WD Gann Wall Street Stock Selector, page 193.

statistician, forecaster, economist, and friend of the law of gravity, he has sometimes been thought to spread himself too thin.

The methods by which he reached his conclusions were a problem. They involved a hocus pocus of lines and areas on a chart. Intuition, and possibly even mystics, played a part. Those who employed rational, objective, and scientific methods were naturally uneasy about Babson, although their methods failed to foretell the crash."

2. The recent internet mania is a once in a generation event. But it is history repeating, this time just a different 'new' technology.

Galbraith again, on 1929, page 71;

"Inevitably promoters organised some new companies merely to capitalise on the public interest in industries with a new wide horizon and provide securities to sell. Radio and aviation stocks were believed to have a particularly satisfactory prospect, and companies were formed which never had more than a prospect.

In September 1929, an advertisement in the Times called attention to the impending arrival of television and said with considerable prescience that the commercial possibilities of this new art defy imagination."

3. This year, 1998, for the first time ever, investors had more mutual finds to choose to invest in, than stocks on Wall street. Not only this, the most popular funds have been index funds. And that has important ramifications.

Index funds simply invest in stocks in the same percentage as the index in which that stock is included. Over several years now, these index funds have been outperforming almost all fund managers. So US savings have gone more and more into index funds. This is self perpetuating. The more a stock rises, the bigger percentage part of the index it becomes, the more the Index funds have to buy it, to match the index performance. And so on. In 1929, investors discovered this works in reverse as well.

Galbraith again on 1929, page 72;

"The most notable piece of speculative architecture of the late twenties, and the one by which, more than any other device, the public demand for common stocks was satisfied, was the investment trust or company. The investment trust did not promote new enterprises or enlarge old ones. It merely arranged that people could own stock in old companies through the medium of new ones.

It is hard to imagine an invention better suited to the time or one better designed to eliminate the anxiety about the possible shortage of common stocks." (After 1929, the value of most investment trust fell to zero.)

4. The internet is allowing more and more investors to be closer and closer to the market. And to watch the market day and night. Special instructions and rules have had to be laid down by stock exchanges of course. It has also allowed investors to follow the course of the stock market almost minute by minute.

Galbraith noted of 1929, page 105

"It follows that to be out of touch with the market, ever so briefly, was a nerve-racking experience. Happily, this was not often necessary. Ticker service was now nationwide; a local telephone call would get the latest quotations from almost anywhere. A journey to Europe provided one of the few troublesome expectations. As The Literary Digest pointed out during the course of the summer, Transoceanic brokerage business has been growing to immense proportions.... But there has been an interlude of uncertainty and inconvenience for speculators crossing the ocean.

In August even this interlude was eliminated. Progressive brokerage houses - a leader was M.J. Meehan, the specialist in radio and a veteran of many notable manipulations - installed branches on the big ships under special regulations laid down by the Exchange. On 17 August, the Leviathan and the Ile de France left port fully equipped for speculation on the high seas.

Business on the Ile the opening day was described as brisk. One of the first transactions was by Irving Berlin, who sold 1,000 shares of Paramount-Famous-Lasky at 72 (It was a shrewd move. The stock later went more or less to nothing and the company into bankruptcy)"

5. Financial or other scandals always come out at economic peaks. This year Russia and President Bill took the spotlight. It is certain there are more to come. 1929 was just as spectacular.

From *The great Crash, 1929* page 113,

"Along with the downturn of the indexes, Wall street has always attributed importance to two other events in the pricking of the bubble. (One was) In England on 20 September 1929 the enterprises of Clarence Hatry suddenly collapsed.

Hatry was one of those curiously un-English figures with whom the English periodically find themselves unable to cope . Although his early financial history had been anything but reassuring, Hatry in the twenties had built up an industrial and financial empire of truly impressive proportions. The nucleus, all the more remarkably, was a line of coinin-the-slot vending and automatic photograph machines. From these unprepossessing enterprises he had marched into investment trusts and high finance."

6. "The current economic performance, with its combination of strong growth and low inflation, is as impressive as any I have witnessed in my near half century of daily observation of the American economy." Alan Greenspan, Federal Reserve Board chairman, 1998 July

Very similar sentiments were stated in 1929, most notably from one Irving Fischer, a Yale economist, who confidently stated in ealry October of 1929 that stocks had reached a permanently high plateau.

The historical parallels are more than a little unnerving. But we emphasise again EIS is not forecasting a re run of the events after 1929, into a depression. Similarities do not run that far.

The historical parallels are there to help remind us that the herd never learns from history, for that is what makes them the herd.

Net boom defies stock conventions

Eric Ellis
San Francisco

There's a New Boom under way in America's New Economy and a new tradition-flouting market hero to go with it.

Silicon Valley's booming internet stocks leapt by double figures yesterday in the latest convention-defying rally, providing further evidence that a new generation of Gordon "Geekos" – more likely to have braces on their teeth than over a Brooks Brothers shirt – are reshaping Wall Street.

The stock valuations of these new darlings of the market, such as Yahoo!, Lycos, Excite and Amazon, defy conventional analysis. Many are yet to post any significant revenues, let alone profits.

The search engine Yahoo! led yesterday's market charge, its shares jumping by 15 per cent to top $US200 ($324) for the first time. At Christmas 1996, they were just $US10.

The online bookseller Amazon soared 12 per cent to $US139.50. Its year low is $US9.56.

Australian investors have also caught internet fever, after New York's NASDAQ market pushed OzEmail's American depository receipts up 5 per cent to $US26.69, well ahead of the stock's 52-week low of just $5.87.

Shares in OzEmail leapt 36¢ on the local sharemarket yesterday to hit a new high of $4.11, revaluing the company on the strength of its potentially valuable search site and content business as well as its core internet access service.

Yesterday's New York market rally – which saw every major internet company except Netscape shoot up by double-figure percentages – was prompted simply by the news that one of them, the search engine group Lycos, would make a two-for-one stock split.

Fig. 2. AFR article, 8th July 1998

Japan

Handle with care.

Japan's problems stem from this; to counter some of the astonishing bank practices of the mid 1980's, the Bank for International Settlements (BIS) – the bank for central banks – started demanding better loan standards from member banks, ie adequate reserves on hand relative to its loan book. An exception, more of a compromise, was made for Japanese banks. They were permitted to include their stock market unrealised capital gains, as part of shareholders funds. Fine in a booming market.

Hence constant Japanese government attempts back in March to bolster the Nikkei. Every time the Japanese stock market falls, so does each banks capital base. It is not hard to see that this situation easily develops further to create a scarcity of credit, that vital oil upon which Capitalism is founded, worsening an already severe downturn.

Restructuring must take place. The question is how bad must things get before the systemic restructure takes place. Nobody likes change, least of all established power bases.

Cutting the interest rate still further in Japan, as done recently, putting the rate at just above zero, may look like good news and a sensible thing to do under normal circumstances. Lower rates stimulate business right ? The Japan situation is anything but normal.

The rate cut will only further weaken confidence in the system as consumers and business further hoard cash, or continue to export it to the US in search of better rates. ie sell Yen, buy dollars.

And the situation gets worse.

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Liberals stint on telecoms aid: JNA chief

Charles Wright

The chief executive of JNA Telecommunications, whose directors yesterday recommended acceptance of a $114 million takeover offer, described the Howard Government as "a disaster for the telecommunications industry".

Mr Peter Davies was the first engineer employed by JNA, which began with £300 in capital on the front verandah of a house in Naremburn, on Sydney's north shore, and gradually built industry-leading expertise. He said the Government had "pulled out every form of assistance" but had failed to form the partnership with industry that was crucial for success.

"I would have to say I'm not of the mentality that says there should be government hand-outs, but there needs to be a partnership between government and industry."

KEY POINTS

- JNA's chief executive says the Coalition has been disastrous for telecommunications.
- JNA accepted a $114 m takeover offer yesterday from a US firm, Lucent Technologies.
- Mr Peter Davies said the Government had failed to form a partnership with the industry.

"The present Government has zero understanding of this industry and what's important for this country, and because of that, the chances of attracting people into this industry are pretty remote."

Mr Davies said government support for the industry overseas provided companies with "face, credibility and endorsement", and Labor government backing in Asia had been a vital factor in his company's international sales.

He had been able to make personal contact with the two previous ministers for industry under Labor, but had not been able to meet the present minister, Mr John Moore.

"His office has shown no interest in us as a company, and in this industry. I rang them once to talk to the minister when we were in need of urgent assistance, and they said I wouldn't be able to get an appointment for four months. I have never experienced anything like it. I find it totally unbelievable . . ."

JNA had survived the hardship caused by the Government's cutting of research and development tax deductions from 150 per cent to 125 per cent, but the Government had not taken into account the fact that overseas competitors still received deductions of 150 per cent, or even 200 per cent.

"Australia needs to match what other countries do if it wants to be competitive. You can imagine trying to be part of a global industry out of this geographical location without the lack of understanding at government level."

Mr Davies said the Lucent takeover of JNA was evidence of a structural shift in telecommunications. Telcos were competing more fiercely for the enterprise customer, and sourcing direct from major global organisations.

"If you put JNA in that context, or any other Australian company, it is inevitable if you are going to be any sort of a force, you are going to need to be [a global organisation].

"There is an opportunity for Australia if we can attract these companies to invest. They want to have a strong presence in every country. You cannot ignore it; you can't shut the doors. We have to get behind it and create an environment which encourages investment, where we can do more R&D locally."

In the company's official response to the offer, Mr Davies said JNA's limited global marketing resources and reach may make it difficult to achieve a sufficient sales volume for it to receive optimum return on its R&D investment.

The chairman and founder of JNA, Mr John Almgren, in recommending acceptance of the bid, said the $3.75 per share offer was the result of a competitive international search conducted with the assistance of DeutscheBank. There were no higher offers.

Herald Sun

Business

ALL ORDS ▼ Down 3.4 to 2599pts DOLLAR ▼ Down 0.50 to US60.18¢ 10-YEAR BONDS [illegible] .12 to 5.58%

Meet Ralph, the man who unleashed Wall S[illegible]bear

Mover and shaker: Ralph Acampora is rattling Wall Street.

Ralph Acampora fired the gun which sent a volley through Wall Street, says ANDREW BUTCHER in New York

RALPH Acampora could barely disguise his pride this week.

The chief technical analyst of Prudential Securities was the man whose opinions were being credited with knocking 300 points off Wall Street's Dow Jones index on Tuesday.

Known for his positive views of the market, he had announced to his clients and then the business media that he had turned negative.

Mr Acampora dumped his previous predictions of the Dow index reaching 10,000 points later this year and, instead, predicted a fall to about 7500 points.

The market's reaction cemented Mr Acampora in the select group of individuals branded "market movers".

For the rest of the week, billions of dollars worth of share trades were made on the basis of his opinion and the views of Wall Street's most respected female analyst, Abby Joseph Cohen.

Wall Street's bulls and bears — the optimists and the pessimists — battled it out with Mr Acampora representing the bears and Goldman Sachs' champion analyst Ms Cohen on the side of the bulls.

Mr Acampora's views helped move the market first.

After stunning the market with his negative assessment, he claimed falling share prices were the result of the fundamentals of the market and not his comments.

When asked about being held responsible for the fall, Mr Acampora said, "You'd hate to think that one person could do this, but I think the popularity of (television) business shows and all the media attention that it gets, I guess it becomes a bit of a catalyst."

But his claims of innocence smacked of false modesty.

Later in the week, Mr Acampora conceded it was flattering and frightening that he could have swayed a $US15 trillion ($A25 trillion) market.

Among analysts at securities firms, perhaps only Ms