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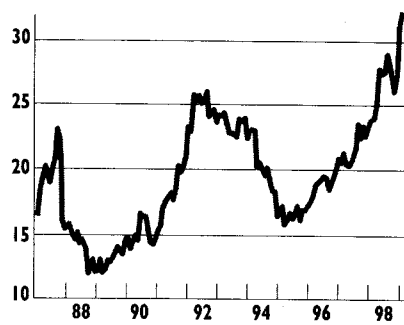


Chart 1.
p/e ratio for the S&P
(US market, top 500 stocks).

The cycles

Commodity prices hit 24 year lows this month. We suggested some years back that they would likely do so this year, and they have. Should history repeat, 30 year lows can be expected, but the final lows for this Kondratieff wave are not far off now. Commodity prices have, over 300 years, been getting progressively lower over the long term trend, despite the higher prices from time to time.

But note, nothing cures low prices, like low prices. The big mining companies are flat out now introducing better technology, or taking over smaller operations. (The Westralian / RGC mineral sands merger is expected to slash \$100 million from operating costs.)

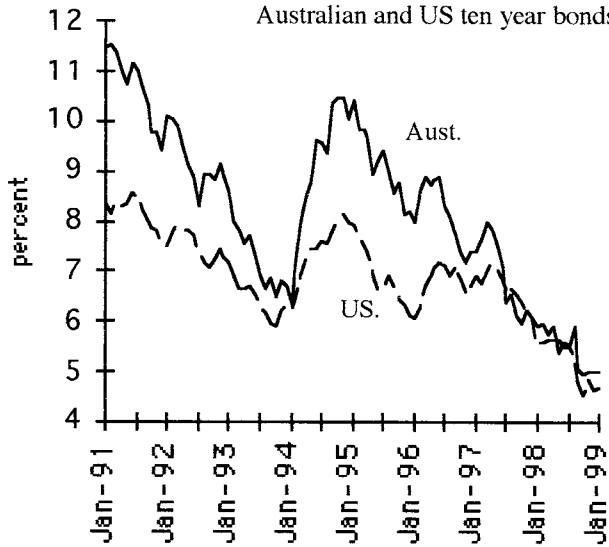
Decade cycle

We are now in the 94th month of expansion. The last decade cycle ran 90 months (1983 - 90). Presently, the following can be observed at this time in the cycle;

- Boeing Co. (the worlds largest aeroplane manufacturer, they produce two a day) expects its plane deliveries for 1999 to be around 620, a figure which would overtake the previous cycle peak in Boeing production levels, recorded in 1991.
- Cuban cigars are back (popular when plenty of money is around), but counterfeit cigars are taking business from the real thing having recently flooded the Australian market.
- The US savings rate has actually dropped to near zero, occurring in Sept / Oct last year (chart 9, page 8)
- The S&P index price earnings multiple stands at 32, double the long run mean of around 14. Valuations are stretched to say the least, though some have been heard to say p/e valuations are no longer relevant today. Chart 1.
- Margin lending (borrowing money with shares as the security) is running at record levels, especially here in Australia.
- More people than ever before are in the market. Nothing wrong with that, except that many buy in toward the peak.
- chic bars are booming in and around Melbourne CBD, with the number well up on levels of two years ago.

Evidence points to an approaching decade cycle peak. The above behaviour is usual at this time in the cycle, though it can continue for some time yet. Further evidence of the cycle turning is Australia's deteriorating current account deficit.

Chart 2.
Australian and US ten year bonds..



Capitalisation, \$US, Billion

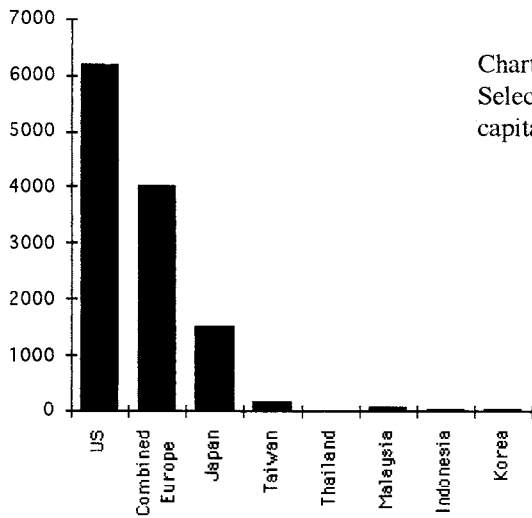
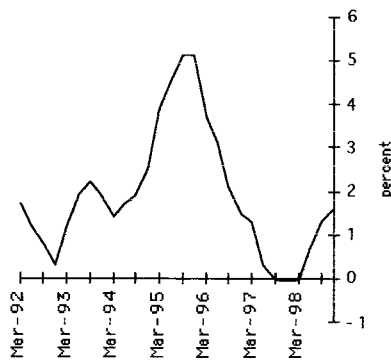


Chart 3.
Selected stock market capitalisations.

The US stock market is big. A downturn there will affect everyone, not just the US.

Chart 4.
Inflation rate, Australia, '92 to current.



Interest rates.

Forecast

Stability in rates can be expected. In Australia, pressure remains on the down side.

Comment

This year it is a little harder to forecast the direction, up or down. In the US, the next move may be up slightly. Be aware that with a US stock market at such stretched valuations, the slightest move up in rates can start an avalanche of selling.

Watch the next move in the United States. Bear markets are most often started by a lift in interest rates - often lifted at the peak of the business cycle.

Inflation.

Forecast

Inflation is expected to remain at low levels.

Comment

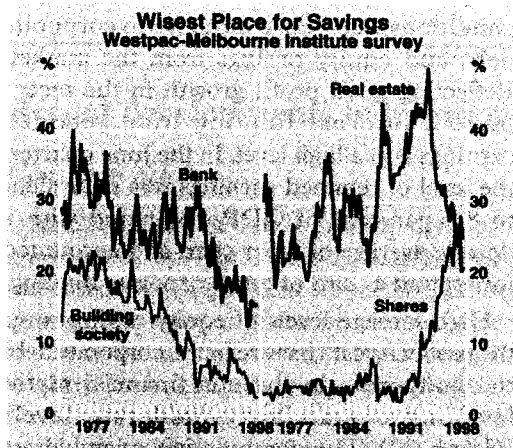
Much depends on the direction of asset prices, especially the US stock market. A bear market could see inflation move below zero, otherwise inflation can be anticipated to remain stable, a non event.

With continued and relentless cost cutting by the big Miners, and continued new technology, it is hard to see inflation as a problem, especially should the business cycle turn downwards.

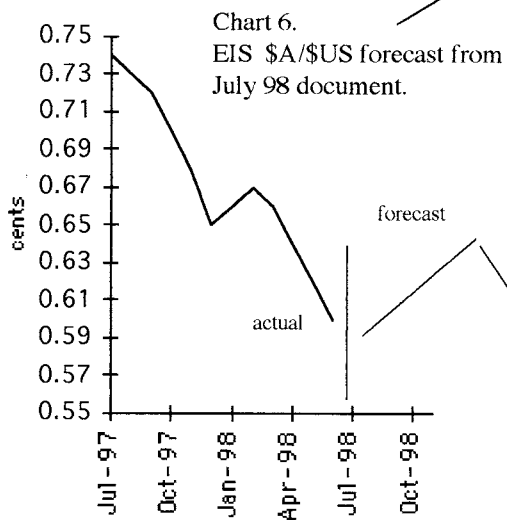
EIS is of the view that inflation could be something we may never have to worry about again in our lifetime; similar to many other long periods throughout history, the last forty years of the 19th century being one example. Throughout the 19th century, with just a few exceptional years, the population routinely looked forward to, indeed expected, lower prices for most goods.

This builds totally different expectations into consumer behaviour.

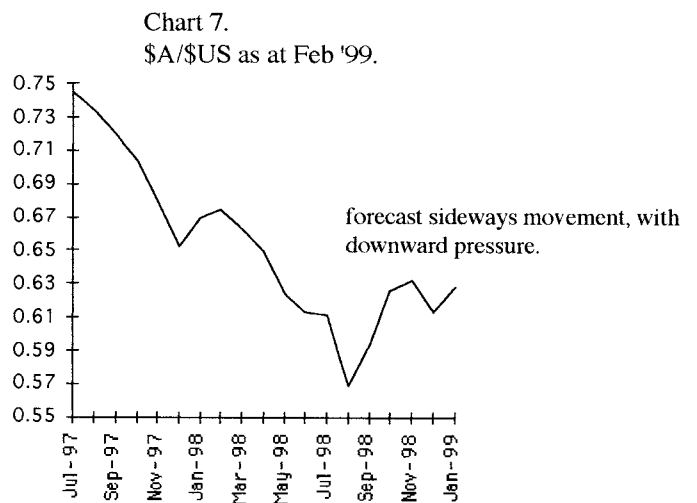
Chart 5.
 Wisest place for savings, Westpac - Melbourne
 Institute survey Source: RBA (with permission)



EIS forecast from July 1998.



Actual after July.



Property.

Forecast

Values can be expected to remain buoyant throughout 1999.

Generally, property prices peak within the business cycle, after share prices peak. So this leads one to think there is still room left to move on property prices for this cycle. Price rises from here though can be expected to be subdued; the interest rate reductions have built themselves into property prices now, plus, from chart 5 we see a decided shift in emphasis by investors throughout the 1990's, away from property, as their preference for savings. Can much credence be placed on surveys? Who knows. But the shift is pronounced nevertheless.

Comment

ABS construction statistics continue to show Australian building activity is firm. In fact construction approvals, in real terms, are running at record levels. As EIS has noted for you before, property activity this decade is much more "location" based than last decade, when activity was everywhere.

Worth noting

The world's tallest buildings are usually commenced at the top of the decade cycle, and generally completed and opened for business at the trough. We note that Grollo's tower is due to start very soon, and if it does start, due for completion within five years. Anecdotal evidence in trying to measure the business cycle to be sure, and certainly most unscientific, but there's a potential date for a downturn in the property sector, assuming history were to repeat.

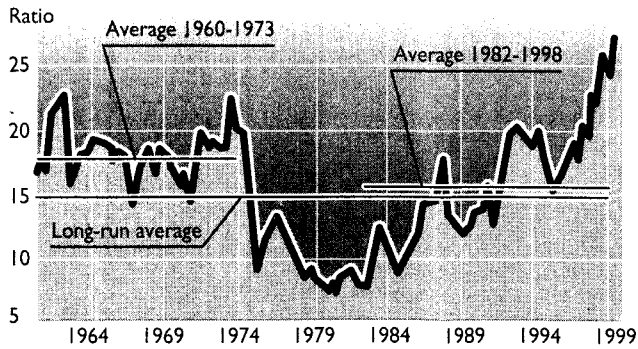
Given the repetition of the Kondratieff wave, EIS would anticipate continued high demand for property by those seeking to rent, rather than buy. This trend could last another decade in Australia, or until the unemployment rate gets back to much lower levels.

\$A

Forecast

Resource economies like Australia are unlikely to experience strong currencies this year. EIS expects our dollar to continue to come under selling pressure from speculators. The direction for our dollar is expected to be sideways, with downward pressure in some months highly likely. (Combined with a worsening current account deficit, our Reserve Bank will have a difficult time reducing interest rates much further.)

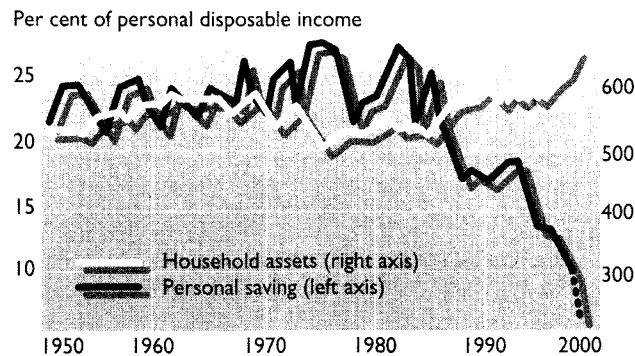
Chart 8.
 US price earnings ratio, all stocks.
 Source: RBA (with permission)



The price earnings ratio; current share price, divided by earnings per share. The combined p/e ratio is of all the shares in the market. Overvalued means, the possibility that prices have risen by more than is justified from earnings.

The price earnings ratio has traditionally been used as a measure of market value. Its present level, 28, is higher than at any time since the 1950's. The long run average is 15.

Chart 9.
 US wealth and saving.
 Source: RBA (with permission)



The wealth effect. If the value of your assets is rising strongly, you feel wealthier. (The US market has tripled in value since 1995.) A spending increase usually results, which cuts into the rate of savings. In the US, the value of household assets has risen quite sharply, and the savings rate has now fallen close to zero. A Wall street correction, should one occur, is to be closely watched. It would destroy unrealized - but already spent - capital gains.

Stock market

Forecast

This issue we list a few charts. It is going to take some effort for our market to move above 3000 in the near term. All the good news about the economy is now priced into the market. We are due for a retracement to lower prices over coming months.

Chart 10.
ASX All Industrials dividend yield,
1974 - current.

When inflation is low, and a dollar is holding its purchasing power, investors can be more patient, and wait for capital appreciation. Companies use share buy backs more often, in preference to boosting dividends. (IBM has averaged some \$8 billion in buy backs each year for the past 4 years.) So note that dividend yield as a measure of market fair value will stretch a bit, and stay longer at a lower yield.

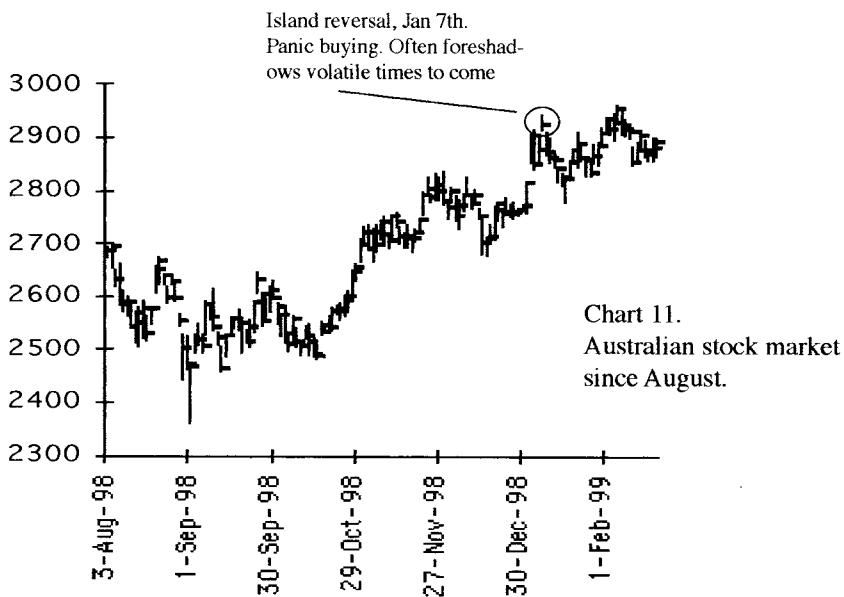
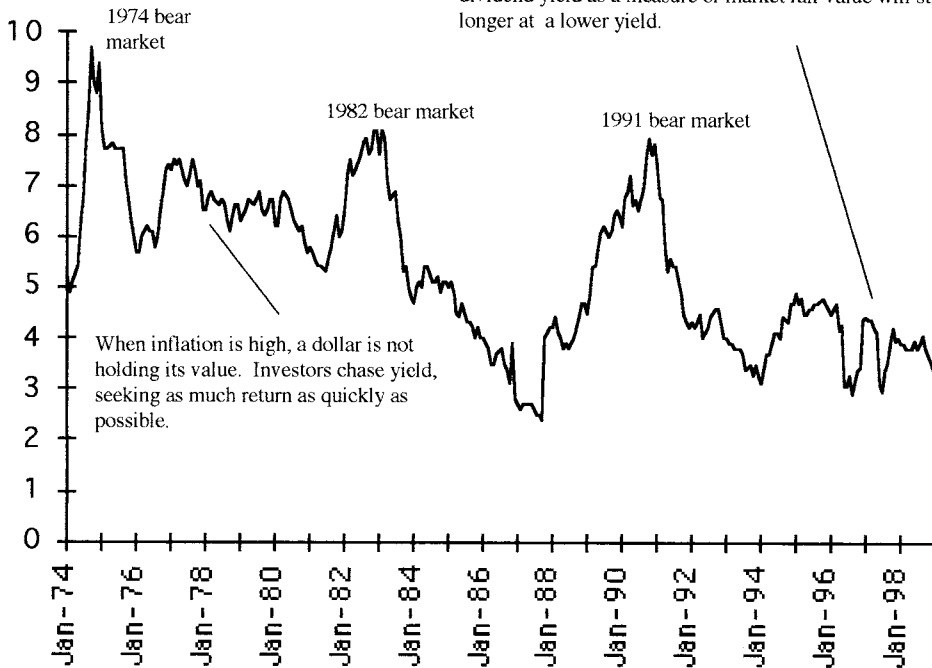


Chart 12.

Comparative trends of several economic indicators, Japan, 1955 - 1988.

Source: Institute of Economic Research on Construction, Tokyo, 1989.

Taken from "Economic Intelligence", June '94 issue, Centre for Incentive Taxation.

Tokyo land prices peaked at astronomical prices in 1988. The country is still recovering.

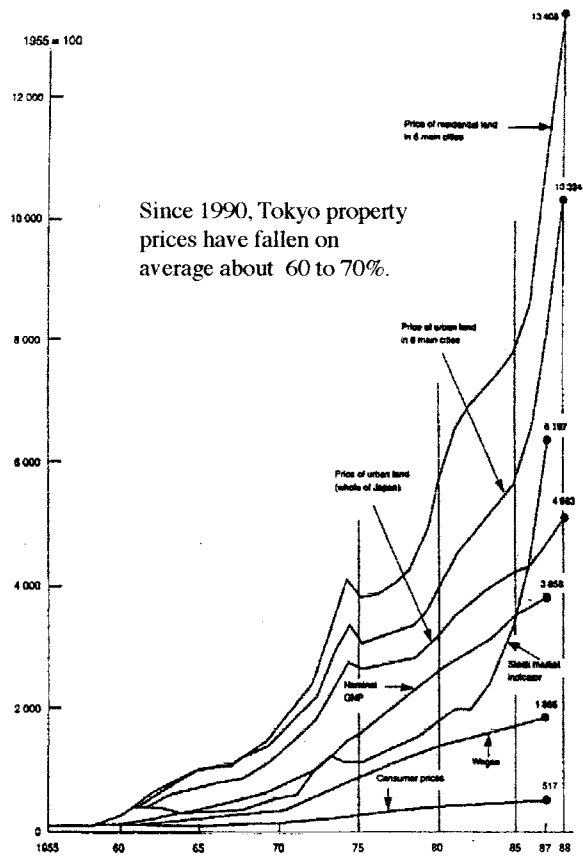
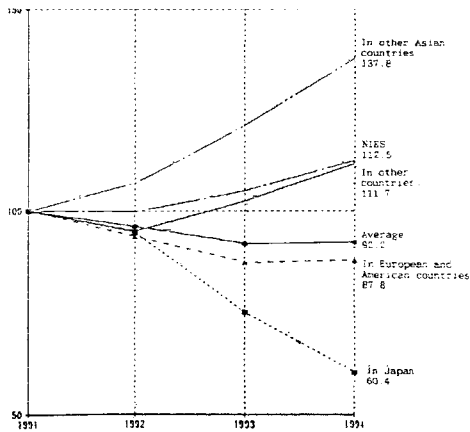


Chart 13.

Commercial land prices various nation groups.

Source: The world Land Survey, 1995, quoted in The Chaos makers, p 32



Asia's land values peaked first. The countries concerned then went into recession.

**Measuring value;
the predictive ability of government granted privileges**

Comment

There are three things that produce wealth, natural resources, labour and capital. All three are needed to produce the wealth, and our society does it pretty well too. But the value of this wealth of production is always captured, (in fact often anticipated in advance), in the price of what EIS likes to call government granted licences and privileges; taxi plates and real estate being two. These prices are not produced (in the sense of physically manufactured); they are the result of government laws and regulations (privilege). Which is why EIS measures them.

There comes a time when the price of these licences and titles becomes too high, and starts affecting the production of wealth; the price becomes uneconomic for business to afford. So watch the prices of these items. They forewarn us (mostly) of cyclic events to follow.

The indicators here are suggesting it is a time to be prudent, and prepare for a downturn. (Though high prices can be sustained for some time).

Much now depends on the direction of the US stock market, notably at present caught in a mania of buying. We'd like to know the value of US land prices, but they're not adequately recorded. (For obvious reasons. Anything measured is soon taxed).

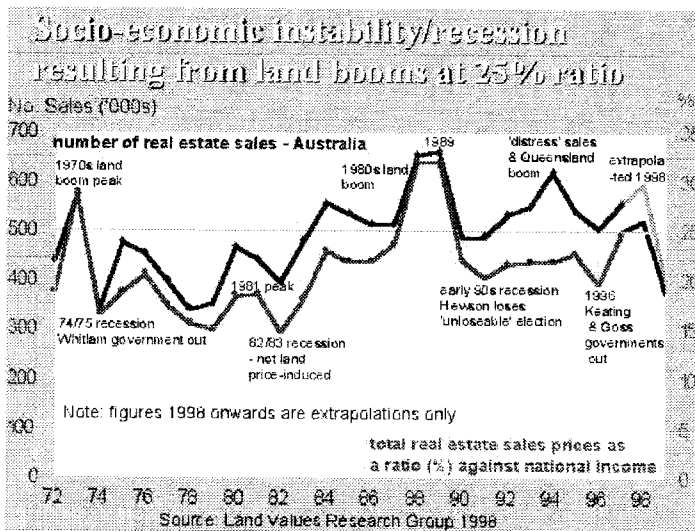
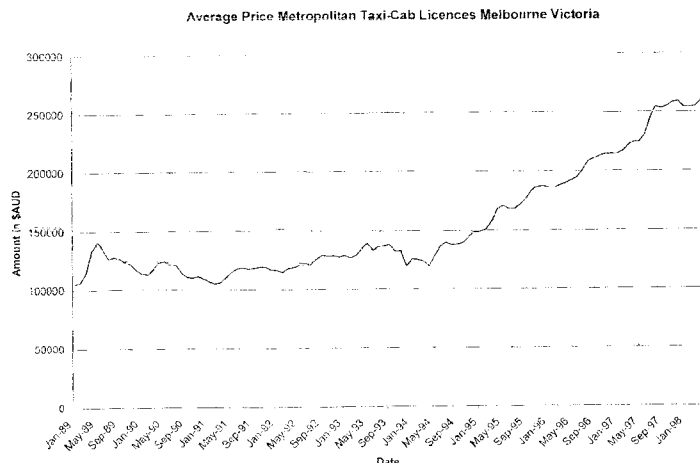


Chart 14.
Real estate sales as a percentage of national income.

Australian real estate values are again approaching speculative levels. So too taxi plates.

Chart 15.
Taxi plate licence prices, Melbourne.

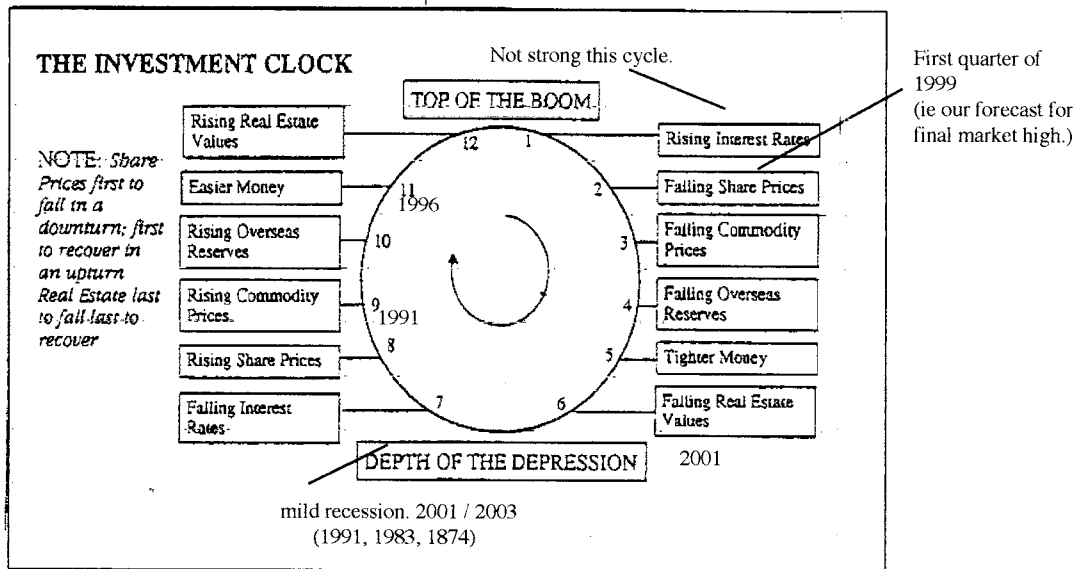


Cycles in numbers

It has always been of interest to EIS, how at certain times when the business cycle repeats itself, so does the stock market.

It has been some 90 months or so, seven and a half years, since the bottom of the previous recession. (Dated at mid 1991.) This is the same time that the last business cycle went, from trough to peak, 1982/83 to 1989 / 90. Fig. 1.

Fig. 1. The decade cycle



Observe how the All Ords prices (Share Price Index, SPI, futures contract figures used here) have repeated in range between previous high and low points. We've measured this in two ways, as below. Fig's 2 and 3. Does this mean anything? Who knows. However it will take some effort for the market to go above 3000 and stay there.

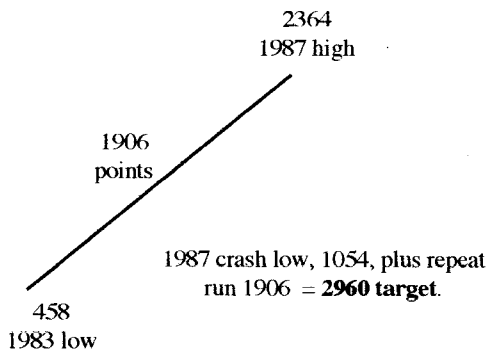


Fig. 2.

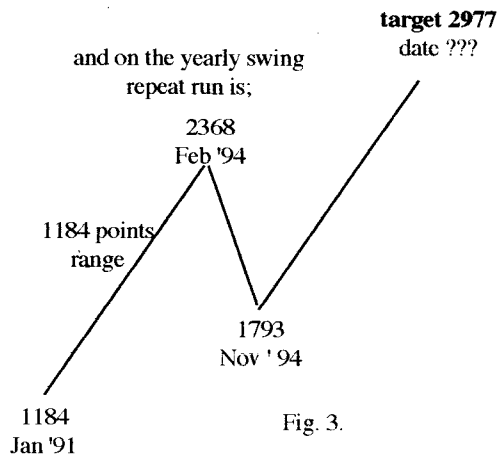


Fig. 3.

Why the cycles will repeat

An old battle in a new field: The battle for locational space

Prior to the industrial revolution, at least in England, land lords ruled the Manor. Agricultural land was the key to wealth. Whoever owned the land, owned the serfs. The start of the industrial revolution brought a fundamental change to the economy, and with it to the power, wealth and control wrought by land lords.

After 1800, innovations in steam power were facilitating the increased production of wealth. Land (location) was sought for a different purpose; canal building and textile factories run on water wheels and later steam to generate energy. Ownership of land located next to water brought control over access to the new technology. (Or at least that was where the profits were reinvested.)

The next set of technologies introduced in the second wave produced the same effect. This time the railroad barons were seeking the control, power and wealth that came with opening up the new lands, especially the real estate next to the train tracks.

The third wave, and motor vehicles, opened up suburbia, an effect that continues today. A good location continues to be all important. (Observe where oil companies position their petrol stations, or where McDonalds site their hamburger outlets.) This leads us to an important investment strategy for the fifth wave.

We are used to control over physical space. But just as in the industrial revolution of two hundred years ago, where the most profitable locational spaces moved from the Manor to river banks, so it is today. However the locational space being moved to now is no longer physical, and the battle for it not so easy to determine, nor to profit from.

The new locational spaces are electronic. Ownership of them is creating a new generation of entrepreneurs in exactly the same style as in previous waves.

So to pick the likely winners of the computer and internet wars, and associated company takeovers, apply the same principles as in the past. Look for those companies that have the best control over access to the new technology. Such companies will perform the role of gate keeper over access to those electronic areas where the most people have to transact their business. Just like the former canal owner, railroad baron, then street corner site owner, control, and profits, flow from access and location.

Extracts from 'Business cycles', EIS research, 1989 - '94.

They've been given a name now - "**portals**".

This value is captured (enclosed), indeed often anticipated, in the price of government granted privileges. Prices are often, but not always, then "blown off" in a speculative frenzy.

Remember; at such a time, there are always hi flying entrepreneurs around who know the price of everything, but the value of nothing. Only the fittest survive the ensuing downturn.

The change is profound, don't ignore it.

I had occasion to go travelling for a few days last month once again, as I am wont to do. Some ten years ago now, I spent several years on the road visiting most places in the world. Numerous friends were made, addresses swapped, postcards mailed. The postcards, letters and stamps cost me a small fortune.

In the travels this year, I met many fellow travellers like the old days, but the expectations were different. This time email addresses were swapped. And who cares about location? Contacting home? Simple. A quick trip to the public library, log on and send messages to everyone. With the right software I could even chat real time. And it was free. (How far away can the intro of timed phone calls be?)

Now this might not seem a big deal to you, but it represents a profound change in thinking, and in expectations of young people; our future business customers. They will expect instantaneous service and satisfaction, through modern means of communication. And expect it cheaply. Only above average service will be satisfactory.

The internet will completely change the way you will do business in the future, though in ways that are as yet unforecastable. You ignore developments in technology at the risk of future business profits.

And another observation given to EIS from a well connected traveller, recently returned from a one month sojourn in the States;

With interest rates low, everyone in work and steadily rising wages they are confident of disposing of their total current incomes on repayments, motor vehicles and consumer goods for those houses.

This spending is creating more jobs and wealth in the domestic economy. The sense of wealth and confidence in the community is palpable. For example producer sponsored motor vehicle leases are so competitive it does not make sense not to buy. New vehicles of the highest quality abound.

This household wealth effect may well be enhanced by the increased value of their stock portfolios and rising house prices. The removal of CGT on resale of the family home will push this further.

Strategy.

~ Innovate;

Take account of the new technology and new ways of doing things.

~ Revenue growth;

Less emphasis is required now on cost cutting, (unless you haven't started) and the emphasis should be changed to maximising revenue growth.

~ A clear and written business strategy is required today. It has often surprised us just how many businesses don't actually know what business they are in. Let us illustrate what we mean; Is a hairdresser in business to cut hair, or make people feel more positive about their looks? If you manufacture spare parts and components, are you in business to make parts, or are you in business to support the profitability of your customers. How you answer this question about your own business will determine your business marketing, innovation, finance and human resource strategies. In other words, your revenue growth and hence business success.

~ Find better / faster / cheaper ways to reach your customer, with a decided effort on your best customers, ie the client that returns the greatest profit. Service them better.

~ Take out a subscription to a good US business magazine eg Fortune. The US is where the technology is all happening and you need to be aware of the trends.

~ As noted in our cycles section, (p3), margin lending is at record levels. It is prudent to take account of this fact. At market extremes, note what the herd is doing, and don't follow them.

We all need some fun:

EIS has been having a go at the speculative end of the market - internet stocks, and with modest success. But we don't bet next weeks rent on the outcome, and make some effort to take profits where achieved. The net is not a long term investment just yet. Know your time frame. Know your money management rules. The music will stop eventually.

Tip

Make hay whilst the sun shines. But note what the wise farmer does with his hay; stores it for the winter.

A few additional comments

Gold update

We note that Switzerland is undergoing a parliamentary vote this year that will permit a referendum next year that, if approved, will permit the sale of a proportion of that nation's gold reserves. Switzerland stores a lot of gold. The effect on price is obvious.

The introduction of the Euro is also further evidence of the reduced need for gold. It is decidedly possible that gold is in the slow process of being demonetised, much like silver in the 1870's. If so, this will herald gold's return simply to that of an ordinary commodity.

Notably, upon the introduction of the Euro, the European Central Bank decided to hold only 15% of its reserves in gold; about 700 tonnes worth. This leaves 12000 tonnes as surplus, still being held by individual European central banks. For readers with a gold bug, watch developments here. In two years time Deutchmarks, Lira, Francs etc become obsolete, with a much reduced role for individual European member nation's central banks. What will they do with their 12000 tonnes of gold ??? We'll keep you posted on that one.

We note with interest also, Joe Gutnick's continued foray into biotechnology through his listed vehicle Australia Wide Industries. Now what's a shrewd gold man doing in biotechnology ?

Y2K bug

EIS is of the view that the bug thing is way overdone. Most of America, Europe and the UK is well prepared for any problems. Wall Street will beat it, so will most of the banks. There may be problems in third world nations, and Asian areas, but an Armageddon ? Not likely. (Remember, emotion sells newspapers.) There is every possibility that towards the end of the year, it may lead to an actual build up of inventories as people commence hoarding. This may actually be beneficial for Western companies, and their stock prices.

From a psychological perspective, much will depend on how Wall street is performing, closer to year end. Watch April 1st (no joke) this year, for the first hint of any serious problems; it is the British and Japanese financial year end, and hence the turning over into date 2000.

" The markets presume capital efficiency of the American economy has improved in a very significant manner. Indeed, the consequences of that are all around us....We have an economy that is functioning exceptionally well."

Alan Greenspan, US Federal Reserve Board Chairman, in testimony before the US Senate house banking committee, Feb 1999. The comments went unreported in the Australian press.

Greenspan went on to say the US economy *"is the envy of the world"*.

The sun always shines brightest at midday.