



The Newsletter of the
Association of Benefit Administrators

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insights

Where is the Outrage?

Dr. Thomas J. Mackell, Jr.

We have all been witnesses to a revolution in the world of work! This revolution has been the growth and development of employee benefit programs over five decades. In the past ten to fifteen years, stock market conditions have helped benefit fund assets explode.

However, along with this enormous growth in the assets of benefit funds, we have also witnessed a sinister plot to "deinstitutionalize" employee benefits. Namely, remove the responsibility of providing benefits from the shoulders of the institution and place that burden and responsibility onto the shoulders of the individual.

Although it may sound a bit dramatic, I do not think that it is too outrageous to ask the question, "Will there be employee benefits as we have known them in the 21st Century?"

In recent weeks, in the wake of another surge in the stock market, several major

corporations announced a fresh wave of downsizings, laying off tens of thousands of workers. On the flip side of the coin, the Department of Labor released data showing that American employers expanded their payrolls by an estimated 267,000 workers in November. Unemployment fell to 4.4% from 4.6%, coming close to the lowest rate in the last three decades.

Those kinds of statistics would give the impression that there should be little pain experienced by working families. We know that it is not the case. What some have referred to as the "Goldilocks" economy, I would be more inclined to characterize as the "Jeckyll and Hyde" economy.

The commentary in a recent issue of *Business Week* carried the heading Exxon Mobil Meets Amazon.com. It provides a snippet of an explanation of this dichotomous economy. It stated that "Technology is a relentless force that creates and destroys with little pity. For proof, look no further than the imploding oil industry and the booming Internet. What was once a colossus bestriding the world -



President's Column

by Dr. Thomas J. Mackell, Jr.

President

Association of Benefit Administrators

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Big Oil – is shrinking. And what didn't exist for most people a decade ago, the Internet is exploding with new companies and new opportunities. (Peter) Schumpeter's (the Economist) description of capitalism as 'creative destruction' is apt. But it does not go far enough. Technology works by changing the very rules of the economic game."

"Rules", the operative word, demand our attention. A growing American economy that can make a billionaire out of someone with an unproven idea for Internet marketing is still sloughing off workers in older industries. Those who have been downsized understand the havoc that technology has brought to their workplace, but on the other hand, they may have seen its advantages in other aspects of their lives. For many others, the specter of technology may only be a looming, ominous shadow which has not yet struck.

The only certainties about technological change are that it is constant, at times very painful and, in the end, positive for economic growth. And, as the *Business Week* piece concluded, "Along the way, it breaks established rules for just about everything."

History has taught us, especially labor history, that there is no social progress without personal commitment and without personal commitment there is no institutional commitment.

At a time when Americans are clamoring for a leader/hero, our political and elected legislative representatives should be beseeched to rally and reinforce the social safety nets to protect the disenfranchised – those who have been cast aside by unforgiving economic change. Instead, our elected officials pass the time ruminating and pontificating about new political platitudes like the "Contract with America", "family values", "compassionate conservatism", and "practical idealism" or espousing ideas of individual self-reliance, responsibility and morality while their constituents are drowning in this new economic order. We live in an era of politicians without policies. Where is the outrage?

Substantive issues like just and affordable health care, protection and enhancement of our Social Security system, the notion of a guaranteed job and realistic retraining programs unfortunately are not part of a legitimate national debate. These are real issues. Failure to address them defines the type of society we are today and will be tomorrow.

In the past couple of years, we have begun to see the type of personal and institutional activism that came to life six to seven decades ago in this country. Institutional commitment must continue to rise up like phoenix from the ashes.

HEALTH CARE TRENDS

Five years ago we witnessed a half-baked effort to promote health care reform. Political sniping and posturing sidetracked that campaign. For a time the health care provider community re-designed its act, promoted efficiencies and drove costs down. Perhaps, some would say, because of the fear of oversight of a potentially successful reform effort.

Health care today is an expensive commodity that is more concerned about profit margins than providing accessible, quality care to all.

Today, 43.4 million working Americans who are too young for Medicare and not poor enough for Medicaid are without health insurance coverage. Projected costs for premiums for those 160 million workers with coverage range from 8 to 20% over the next year. Where is the outrage?

Finally, there is a growing corporate interest in medical savings accounts patterned after defined contribution pension plans. It appears to be yet another potential method to "deinstitutionalize" the responsibility.

PENSION TRENDS

Achieving financial security for retirement is a complex process that is not getting easier. The need to educate American workers and employers on the importance of planning and saving for a secure, comfortable

and dignified retirement is critical. The combination of social, political and economic factors over several decades contributed to creating a blueprint for retirement security along with the recognition that a vehicle that would provide a modicum of financial security for older Americans, once their work life ended and their retirement began, would do much to thwart the specter of poverty. Over the last four decades, America has experienced a demographic tidal wave of a growing and aging population commonly referred to as the "age wave" that has in recent times reinforced and focused national attention on the need to evaluate where we are today and determine how to continue to provide a secure retirement system for older people.

Traditionally, the three-legged stool of retirement, Social Security, personal savings and a retirement plan, commonly referred to as the "three cornerstones" of retirement income has been promoted as the most effective combination to provide a secure retirement. All three can most effectively support and strengthen the stool. Unfortunately, each of these cornerstones is in various stages of serious threat of erosion in one form or another and has been characterized as America's looming retirement security crisis. The need for education with regard to savings, pensions and long-term retirement

planning is of paramount importance. Our failure to address this crisis portends for serious long-term societal ills.

We have had the luxury of living in an era, especially, over the last fifteen years of one of the most scintillating periods in U.S. economic history. The complexity and speed with which innovation has revolutionized the world of finance have reached a proportion where it is difficult to comprehend all of the dynamics of this fast-paced change from moment to moment. In the American economic "miracle" everything that should be up has gone up: GDP, capital spending, incomes, the stock market, employment, exports, and consumer and business confidence. Everything that should be down is down — unemployment, inflation, interest rates. This litany of America's economic success may sound tinny to those who feel their lives are buffeted by forces over which they have virtually no control. People are working harder than ever before. The gap between the well to do and the poor has been growing.

Much has happened to change the private pension plan system as well as the methodology for delivering benefits. Since the 1970's, qualified defined contribution plans, participants, and contributions have grown as a percentage of the employment based retirement system. According to the findings from

the Form 5500 series report filed with the Department of Labor for 1994 the count of private pension plans filing was about 690,350, a 2% decrease from 1993. The number of defined benefit plans decreased by 11% to 74,400, while the number of defined contribution plans has decreased by less than .5% to 615,900. The number of defined benefit plans has decreased each year since 1986. The 1994 count is only 43% of the peak total of 175,000 plans in 1983.

The long-term patterns of decreases in defined benefit plan active participants and increases in defined contribution plan active participants continued in 1994. Defined benefit plan active participants decreased by 2% to 24.6 million. Defined contribution plan active participants increased by 2% to 40.4 million.

Many employers have shifted the responsibility for providing for retirement income from their shoulders to the shoulders of the worker as witnessed by the precipitous decline of defined benefit plans and the increasing proliferation of defined contribution plans where tomorrow's retirees' income security will likely depend increasingly on his or her life-long money management skills and decisions.

What would normally have been considered an issue that most people would readily rally around and support, namely, the creation of a pension plan for

employees, has become a debate about who is responsible for the employee's long-term retirement income goals. Perhaps the shift of pension coverage or, more importantly, the lack thereof, has become more noticeable and profound for employees of small employers. Where is the outrage?

CONCLUSION

We all have a role to play in the effort to create universal health care coverage and a national retirement policy. Improving the opportunity for quality health care and a secure retirement for all will do much to impact the economic well being of the United States.

Government, labor leaders, trustees, administrators, corporate leaders, investment managers, consultants and other professionals, employers and employees alike may play different roles in the benefits equation but we should all be bound together for one sole purpose: to enable working women and men to have health care coverage and to retire with a modicum of financial well-being and dignity.



Labor Department Proposes Drastic Changes to Claims and Appeals Deadlines

*By Robert M. Landau, Esq., Partner
Feder & Semo, P.C.*

At the heart of every plan's administration is paying claims. So the Labor Department's proposed changes to the procedures for adjudicating claims and appeals (the "Proposed Regs") may require significant changes for some plans and administrators.

Whether or not it's good for participants and health care consumers, it's plan administrators who will need to understand the new requirements on a nuts-and-bolts level.

Fortunately, the Labor Department extended the deadline for comments until December 9, giving the benefits community more time to study and comment on the details of the Proposed Regs. Many interest groups are developing comments; our law firm is working on comments for the National Coordinating Com-

mittee for Multiemployer Plans. We'd welcome any thoughts you have on the Proposed Regs.

As you've probably already seen in several publications, the basics of the Proposed Regs are easy to grasp as summarized in the chart on the following page.

As you have come to expect with any government rules, there are dozens of details to keep you on your toes—just in case you didn't have enough to do. In the remainder of this article, we'll draw your attention to some of the major issues.

• Preapproval for Urgent Health Care Must Be Decided in 48 Hours; Appeals in 72 Hours

In plans requiring preapproval for benefits, claims for urgent care must be decided within 48 hours. Appeals must be decided within 72 hours. These are maximums, which must be shorter if the circumstances warrant. A claim for "urgent care" arises whenever the patient's life or health is in jeopardy, or treatment is necessary to regain maximum function, but the administrator would have to defer to the attending doctor's judgment. Also, the administrator would have to use a reasonable layperson standard for what is "urgent care." For example, a person complaining of chest pain would have to be admitted to the emergency room, even though it was later found to be heartburn.

	Deadline to send Notice of Deficient Claim	Deadline for Claims Decision	Minimum Time to Appeal	Deadline for Appeal Decision
Health- Urgent Care	24 hours	48 hours	not specified	72 hours
Health- Non-urgent Care	5 days	15 days	180 days	30 days
Pension	5 days	45 days	60 days	60 days
Disability	5 days	15 days	180 days	45 days

Indemnity plans that do not condition benefits on the plan's prior approval must decide claims within 15 days and appeals within 30 days; however, the Proposed Regs are not as clear as we would like on the nonapplication of the urgent care rules to indemnity plans.

• Medical Appeals Will Require Consultation of an Independent Health Care Professional

On appeals involving medical judgment, a "health care professional" with expertise in the relevant field must be consulted. Examples of appeals involving medical judgment include decisions regarding medical necessity and what constitutes an excludable treatment. The Proposed Regs are not explicit about who qualifies as a "health care professional." The health care professional used on the appeal must be independent of any health care professional who participated in the initial adverse claims decision.

• The Quarterly Meeting Exception Has Been Abolished for Health and Disability Plans

In their effort to expedite decisions on health-related claims, the Labor Department will eliminate the rule that allows trustees to hear health and disability appeals at their quarterly meetings. This will force trustees either to: (1) be always on call to consider appeals; or (2) turn over these appeals to their professionals. In either case, administrators will have increased responsibilities. If appeals are turned over to you, as administrator, you will have fiduciary responsibility for deciding these appeals. All of these changes potentially impact your contract with the plan, including fees, fiduciary responsibility, and indemnification.

If you'd like a copy of our detailed analysis and commentary on the Proposed Regs, please contact me at (202/955-8305).



Pension Funds and Market Myths

*By Leo Gerard, Secretary-Treasurer,
United Steelworkers of America,
AFL-CIO/CLC
Chair, Heartland Labor Capital
Working Group*

Three and a half years ago at the National Association of Treasurers' conference in Philadelphia, I listened to a speech by Jude Wanninski, former Reagan advisor and a co-author of the infamous supply-side, "trickle down" economic policy of the Reagan Administration. Mr. Wanninski suggested that it was easy for pension fund money managers to make the required choices in their portfolio investments. Just follow the crowd, invest in emerging markets, and get your wheelbarrows ready to scoop up the returns. I had come to this meeting of State Treasurers because as secretary-treasurer of the United Steelworkers of America, I was trying to find a source of capital for a small \$5 million investment in a fund supporting small and medium sized manufacturing in Western Pennsylvania. I had been trying

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to find that source for months.

I listened patiently to Mr. Wanninski, trying to figure out how investing the deferred wages of Pennsylvanian workers (and any other state) in Indonesia and Vietnam (and any other "Asia Tiger") was a safer, and better investment, than the same amount invested in building local capacity here at home. I was seeking a small investment against the size of the pension portfolios in question. It offered an appropriate risk-adjusted return. The investment was to be used in expanding and modernizing productive enterprises. Used for small manufacturing plants that would employ hundreds of workers in decent, unionized, family-supporting jobs. Jobs that pay taxes to the State of Pennsylvania. Jobs that support communities in the State of Pennsylvania. I couldn't make it add up.

In the market there are myths that prevail. Myths that are said often enough, loudly enough, written in *The Wall Street Journal*, and the *Harvard Business Review*, until fairly soon these myths become fact. The myth of investing in emerging markets is just one. One that cost dearly in 1998, and will probably cost more in 1999. But the facts don't back up these market myths. It turns out there is no correlation between excessively high CEO compensation packages and increased profitability of firms. The fact is that CEOs'

compensation relates more closely to their golf score (the higher the compensation, the lower the golf score) than to their added productivity. While it happens that more often than not, companies that downsize lose rather than gain shareholder value over the long run.

But market myths currently allow a narrow band of money managers to direct the use of trillions of dollars of workers' savings against their real, long-term interests in the economy. We need to blow up these market myths. We need to replace them with a better economic story than the one currently being told by capital market finance. We need to back that story up with facts.

The current economic model is simplicity itself, and its assumptions lie at the root of most firms' behavior. First, the primary function of the firm is to increase value for its shareholders, measured by its price on a certain day. Second, that the capital market is fairly efficient so that it will allocate available resources to their most productive uses in the economy, as measured by their risk-adjusted rate of return on the relevant day. Under these two assumptions financial markets will allocate available capital pools to their most efficient uses, and firms utilizing this capital will only consider the interests of their shareholders measured by increased share value in the short run. Where does the

investment pool originate? Increasingly the available capital underpinning these transactions is deferred workers' wages in the form of pension funds and retirement savings, now totaling \$5.8 trillion in the US alone. What is the prevailing economic story on the objective of these funds? It is that the interests of the plan beneficiaries are best served when their only function is to maximize the risk-adjusted rate of return of the portfolio to the plan members, measured at any given point in time.

Our story states that in the pension industry today, trustees and many other pension professionals who invest billions of workers' dollars, are dedicated to certain principles and professional protocol that don't necessarily reflect the interests of working Americans. Industry professionals know they will be punished (dropped as money managers or chief pension officers), if their investments go bad and it is deemed they did not follow the 'prudent man' rule — which is basically conventional practice.

Conventional practice is dominated by the prevailing market myths. Current conventional practice is to maximize the short run and buy the stocks everyone else is buying in order to maintain similar portfolio allocations. When followed, the money manager's job becomes easy and professionally safe. Our story

says that because many of these market myths are not grounded in fact, this investment pattern is lazy and harmful.

Our story explains that when the firm acts in a manner that values all its stakeholders (workers, communities, consumers, and the environment) today — it creates real long run value for shareholders in the future. Given the time horizons of pension fund beneficiaries, their real long-term interests are served through concern with the long run rather than short run value of their holdings. Therefore the real long run interest of the plan participants is reflected in the short-term behavior of the firm.

Contrary to market myth, the capital market is not efficient and because of its failures small to medium sized domestic firms are not getting access to the capital they need for investment. We say that it is investment in the real economy that creates long run value for shareholders through increased productivity. As a byproduct this investment creates jobs, that in turn create healthy communities. As a result, productive investment in firms that are not able to easily access capital generates additional collateral benefits, also known as double bottom line investments.

Research shows that given a choice between two equal investments measured by their risk-adjusted rates of return, investments with these additional benefits are once again in the real long-term interest of plan beneficiaries.

I wasn't at the State Treasurers meeting to issue a directive to the fund managers about their investment choices. But rather to show that a good return could be made from an investment close to home. It is important to understand that the use of funds in our story is not prescriptive for fund behavior. Too often the literature is full of pension fund "shoulds". I have seen articles that dictate to funds that they should "take on this cause or case, advocate for this or that interest, or fill a void left by shrinking government obligation." - - There is no room for "shoulds" in this argument. The story we want to tell is not an economic case for both doing good and doing well, as if these two actions are unrelated to each other or a haphazard correlation at best. Rather it is a case

1999 SCHEDULE OF ABA EVENTS

Luncheon Meetings

Thursday, February 4, 1999

Thursday, April 22, 1999

Thursday, June 10, 1999

Thursday, September 16, 1999

Thursday, December 2, 1999

International Foundation of Employee Benefit Plans Brunch

Sunday, October 31, 1999

Orlando, Florida

Dinner Dance

Friday, November 19, 1999

The Sheraton Hotel

New York, New York

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for doing good in order to do well. It is a case for matching the time horizons of action and result. We want to build a case for short-term firm behavior that both values and includes all the stakeholders in order to provide the needed sensitivity to ensure the long-term pay off for investors.

Unions have a vital role to play in telling this new economic story. I was pleased to have the opportunity at the White House Summit on Savings last June, to highlight the crucial role that unions have in building the savings pool in this country. Our presence at the bargaining table means that 79% of American unionized workers are saving for the future, while only 39% of non-union workers have pensions. But having bargained for the pension promise is not enough. With pension fund assets now totaling \$5.8 trillion, unions also have a role to play in aggregating the interests of the workers whose savings are pooled. The AFL-CIO has taken on that challenge through the Office of Investment and the Center for Working Capital. The AFL-CIO sponsored meetings with pension plan trustees and money managers in Pittsburgh and Las Vegas last year. Secretary-Treasurer Richard Trumka put money managers on notice about our new economic story.

The Heartland Labor Capital Project, a special task force on these issues I have chaired since 1995, is currently researching the topic that will allow us back up the argument with facts. This project is working with regional groups around the country to put in place Investment Funds that will act as successful intermediaries between pooled pension fund money and the real US economy.

What about the investment that set me on this path three and a half years ago? We are now moving on a scaled-down manufacturing fund which should be in operation next year. And as for Jude Wanninski, he won't be needing that wheelbarrow to carry back the empty promises of market myths.

[Article prepared with assistance from Tessa Hebb, Co-Chair of Policy/Research Task Force of the Heartland Labor Capital Project.]



The Case For Global Equity Investing Until 2002 and Beyond

*By Robert A. Simms, Chairman,
Simms Capital Management, Inc.*

The seven year economic cycle in the US appears mature and the market fully valued. However, Europe is in the early stages of a bull market and the Japanese market (Nikkei) is weakened by recession. We believe that the EAFE (Europe, Australia and the Far East) index will outperform the S&P 500 in the next three to five year cycle. The three reasons are:

1. Valuation - By quantitative valuation measures - price/earnings and price/book ratios, return on equity and earnings growth rates, etc. the EAFE markets are 10% undervalued relative to the S&P 500.

2. Economic - The three major developed markets of the United States, Europe, and Japan are currently in different stages of their economic cycle. The economic climate in Europe will improve steadily over the medium term due to European Monetary

Union (EMU), stable to lower interest rates and effective corporate restructuring. Japan, which represents 16% of the world GDP and 25% of its savings, will eventually recover, although only after substantial reforms are adopted. On the other hand, after seven years of uninterrupted growth, the US economy appears fully mature and could slow with reduced profitability if deflationary pressures increase.

3. Flow of Funds - In Europe, the generational shift into equities is in its infancy. She has had her cities bombed and economies ravaged by two world wars in this century and has been living under the shadow of the Red Army for decades. Assets have been invested in gold, bonds, and the remainder hidden under mattresses. Lower interest rates, pension reform and the privatization of state assets are giving birth to a new equity culture on the Continent where levels of equity ownership are only a small fraction of what they are in the US and UK. In Japan, confronted with a seven year bear market, equity ownership is at historic low levels as well.

The "Goldilocks" conditions (stable economic growth, subdued inflation, declining interest rates, and rising earnings) have been the underpinnings of the US bull market. Investors, led by the "Baby Boomers" who represent the substantial earners and savers in the economy, have pushed the US market to unprecedented valuations. Mutual

Funds, 401(k) and Roth IRA Plans have been their favorite investment vehicles. The "Baby Boomers" bulge will start to decline in 2005.

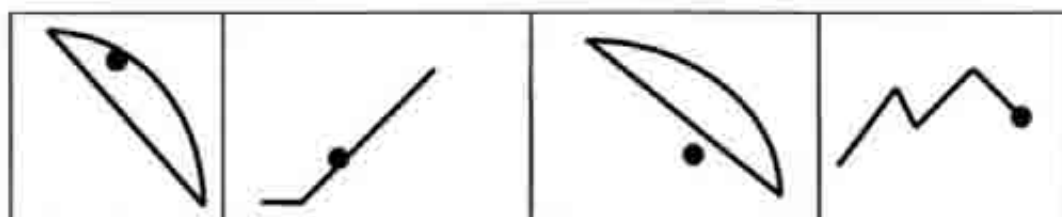
It can be argued, as some market strategists are doing, that the US equity market is fully valued and that now is the time for caution and diversification away from the US.

It is recommended that US equity investors increase their international exposure, not only to reduce risk, but also to enhance their long-term performance. This can be achieved partly by investing in US multinational companies. The emphasis, however, could be on buying foreign stocks (ADRs) as a portfolio of US multinationals delivers substantial economic diversification but no capital market diversification.

Over the last five years, the average annual return for the S&P 500 (+23%) has been more than twice EAFE (+10%). However, in the decade from 1979 to 1989, EAFE had an average annual return of 21.8% versus 16.3% for the S&P 500, and in the five years to 1989, EAFE outperformed the S&P 500 by 36.6% to 19.6%. We could also be at a turning point as shown by the performance of European markets in the first nine months of 1998:

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US vs. Europe & Japan + Emerging Markets



Valuation	PE: 24x ROE: 18-20% Growth: 2-3%	PE: 20x ROE: 16% Growth: 2.5-3.5%	PCF: 10x (vs. 13x for S&P) ROE: 9% Growth: 1%	PE: 12x ROE: 10% Growth: 5-8%
Economy	Seven Year Bull Cycle	Convergence/Mass Market Developing	2nd Largest Economy In Recession	Pacific Recession Latin Amer. Threatened
Asset Allocation	Fully developed pension and mutual fund markets Pension - 55% equity Personal - 45% equity	Underdeveloped pension and mutual fund markets Pension - 10-15% equity Personal - 10% of households own equity	Underdeveloped mutual fund markets Pension - 26% equity Personal - 5% equity as historic home	N/A

Global Indexes: Nine Months 1998 Performance (in US Dollars)

Greece	41.4%
Germany	13.1
Finland	34.7
Spain	13.1
Belgium	29.8
Ireland	10.7
Italy	18.9
Netherlands	10.1
France	14.1
BloombergEurope 500	8.2
Portugal	13.3
United States	4.8

Source: Bloomberg LP

As the above table shows, the United States lagged behind most European markets in the first nine months of 1998, a trend that is likely to be repeated over the balance of this year and beyond as growth in corporate earnings in the US decelerates. The Japanese market was down -15.92% (Nikkei) during the period, but as of 10/21/98 it was +3.85% on a year-to-date basis in US\$ due to recent strong appreciation in the yen versus the US\$ (+16.5% since 9/30/98). Not once in the last ten years has the US market produced the highest

return among the developed markets.

Although we find the arguments relating to current market valuations persuasive, we believe that there are some good economic reasons why overseas markets are likely to offer higher dollar-based returns than US equity markets:

Accelerating economic growth outside the United States. After outpacing most of the industrialized countries in economic growth in recent years, the US may soon relinquish its leadership role to Europe and the emerging markets. US economic growth is expected to slow from 3.4% in 1998 to 2% next year, a rate which Europe could exceed by about 0.5-1.0% over the next 3 to 5 years. Growth is also expected to reaccelerate (3%-4%) in Latin America after a period of stabilization and much of Asia outside of Japan will return to its higher historical growth rate (7-8%). Japan is poised for recovery,

Widespread Corporate Restructuring in Europe and Asia. The US and the UK have been the global leaders in corporate restructuring. As the practices of reducing staff, squeezing wages, and selling or shutting down non-core businesses spread to continental Europe and to Asia, their companies are likely to experience greater relative profit improvement. Return on invested capital in continental Europe, for example, has averaged 16% versus 20% for the US in recent years.

In Europe, monetary union (EMU) has made the need to improve efficiency imperative. The creation of a more unified market of approximately 400 million people with an aggregate economy of \$6.3 trillion (versus approximately 300 million people and \$8 trillion for the United States) will intensify competition and consolidation. A lower cost of capital will contribute to improved efficiency.

Risk of earnings disappointment and/or higher interest rates in the United States.

While inflationary and interest-rate pressures in the United States are still low, slowing earnings progress near term and/or a stronger than expected US economy later could prompt the Fed to raise interest rates, causing a correction in the financial markets. In contrast, easing inflationary pressures in Europe should permit interest rates there to decline this year and next with rising earnings prospects. In emerging markets, rates are expected to decline, injecting more liquidity into those markets.

Non-US markets now account for about 50% of total world market capitalization. Moreover, recent trends and history suggest that their share of world market capitalization is likely to grow. The immense size of these markets indicates how investors who confine themselves to the US equity market could miss out on many opportunities.

In Europe, a growing equity culture will add to the momentum of their current bull market. Investors' preference for debt over equities in Europe is changing. The combination of low interest rates, pension-fund reform, and growing equity supplies, due to the privatization of state assets, is causing European investors to add more equities to their portfolios. The climate for equity investments has also improved as the move toward European monetary integration and the end of

the Cold War have created a sense of political stability on a continent which on a number of occasions in this century has seen equity investments wiped out by war and hyperinflation.

Demographic pressures are the most important of the reasons for the expected shift into equity investments. Most of the European state pension systems operate on a "pay-as-you-go" basis. The aging population means that there will be fewer people of working age to support the growing number of retirees from current pension contributions in the early decades of the twenty-first century. To bridge the gap, European governments are likely to move from unfunded to funded (and compulsory) pension systems and to offer incentives for equity investments, which offer better long-term returns than other assets.

The same demographic pressures are also likely to cause a reallocation of private savings held in life insurance contracts, money market funds and bonds into equities.

According to a detailed study by Morgan Stanley Dean Witter, the flow of funds into European equity investments between now and 2010 could be enormous—a staggering \$13 trillion, equal to 1.5 times Europe's current stock market capitalization.

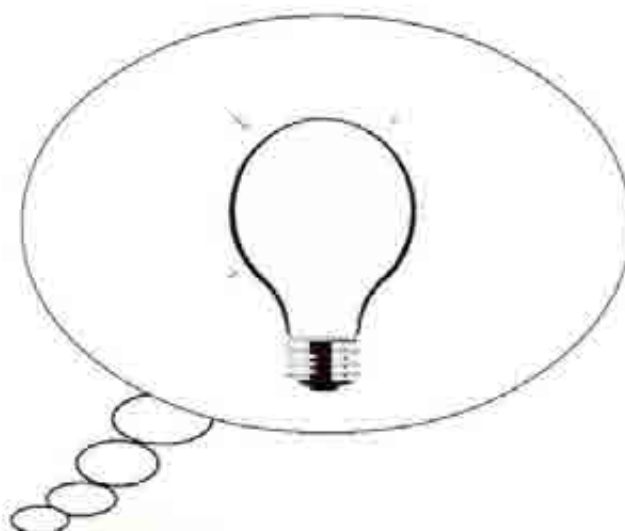
A comparison of US and European investment portfolios is

striking. In the United States, equities account for 55% of pension assets and about 43% of personal assets. In Europe, equities make up 10-15% of pension assets and less than 10% of households own stocks. Even within Europe, there is a wide range. UK pension funds, for instance, own 35% of their stock market, but German and French pension funds own less than 2% of theirs. Current trends have a long way to go before European levels of equity ownership approach those in the United States.

Japanese equity ownership lies somewhere on the spectrum between the United States and Europe. Japanese pension funds have 26% of their assets in equities, but that is down from 29% only a few years ago. Individual investors' interest in equities is at a historic low as equities' share of household assets has fallen to 5% from 14% in 1989. However, the rapid aging of the Japanese population is posing a challenge of how to fund retirement, which is every bit as acute as in Europe, if not more so. When the turn in the Japanese economy finally comes, growth in equity ownership could be explosive in one of the highest savings economies in the world.

International investing involves political risks and disclosure surprises inherent in investing outside of the US, but they are relatively less important when one considers the risk of being invested only in a market which is near its all-time high.

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