A WORLD IN TURMOIL

BIG CHANGES AHEAD—BE PREPARED

THE DILENSCHNEIDER GROUP
36th TREND/FORECASTING REPORT

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EXPECT YOUR LIFE TO BE VERY DIFFERENT

In just ten short years—maybe less—your life will be changed dramatically from what it is today. Many of the trends cited in this Report highlight what is coming. And much of it is positive.

You will live in a globalized world where information moves and is acted on with the speed of light.

The shift in the balance of power will be well underway with Asia and Russia taking new roles.

The shift in pools of capital will be in full swing, with the Middle East and Asia leading the way.

Terrorism will still be with us, but will be reduced in terms of immediate threat.

We will be moving, haltingly, toward a better understanding of the world's religious and moral values.

There is the slight possibility of a major global conflict, but more likely than not, diplomacy will prevail.

Your personal life will be impacted by technology and innovation. You will live in a highly efficient house that uses half the energy you consume today. Sensors will control a lot in your home. Your voice will activate much in your home.

Driving will be safer; buses will burn clean fuel; fewer will drive in the center cities.

Those in the office will use instant messaging and encryption technology; office chairs will have sensors to measure your stress; and much more.

Life will be different in nearly every regard.

IMPLICATIONS FOR BUSINESS: Adapt and accept and drive the process now. Waiting for life to evolve will leave one waiting at the starting gate.

THE 2008 ECONOMIC OUTLOOK IS SOMBER

The collapse of the American housing market, record high oil prices, and the decline in the dollar's value have combined to create a relatively somber outlook for the U.S. economy in 2008 compared with the past several years.

That could translate into bad news for the global economy as well, since a significant American slowdown would have a serious impact on the export-driven economies of China, India, Japan, and Germany. The $13 trillion GDP produced by the U.S. economy exceeds the combined annual output of the world's next four largest economies—China, Japan, Germany, and the U.K.

More troubling still is that a global loss of confidence in the American economy could precipitate a run on the dollar that could lead to worldwide economic problems.

The Global Credit Crunch Extends Beyond Failing Mortgages

Despite hundreds of billions of dollars pumped into the global financial system by the U.S. Federal Reserve, foreign central banks, and a consortium of the world's largest private banks, the liquidity crisis that erupted last August is still unresolved.

As banks, investment houses, and private investment funds announced write-downs of billions of dollars in bad loans, many lenders, borrowers, and financial markets sit on their funds, unconvinced that the bottom has been reached.

At the core of the crisis in confidence is the inability to determine just how deep the write-downs will go. The problem goes well beyond subprime mortgage loans. Banks and investment houses created debt and other new investment securities by bundling batches of credit card debt, home, car loans, student loans, and other debt securities created and sold under the rubric of Collateralized Debt Obligations (CDOs) and Structured Investment Vehicles (SIVs). As confidence collapsed last August with the escalation of defaults on subprime mortgages and other high-risk debt, so did the credit system.

With hundreds of billions of dollars of these bonds and other exotic debt instruments scattered around the world in banks, investment houses, pension funds, and elsewhere, no one could be confident as to their real value. So the market for bundling and securitizing all classes of debt has virtually collapsed, leaving their holders and issuers high and dry.

A dramatic illustration of the credit freeze-up that occurred was contained in the latest quarterly report of the Bank of International Settlements. The report noted that the net issuance of some mortgage-backed securities fell to $3 billion in September, compared with an average of $30 billion or more per month during all of 2005 and 2006. The report noted that borrowing, in general, dropped sharply, with the net issuance of bonds and notes in the third quarter less than half that of the second quarter.

Although the subprime fiasco has wreaked considerable economic damage to banks and investment houses with heavy holdings of the bonds and other securities made up of subprime mortgages and other high-risk debt instruments, so far no major bank or lending institution has failed. But many leading banks and investment houses—UBS, Bank of America, HSBC, Citigroup, Merrill Lynch, and Morgan Stanley—have needed infusions of fresh capital from the Fed, other central banks, or sovereign wealth funds to weather the storm.

Clearly, the world's central bankers are committed to preserving the international banking system from default and will take whatever steps are necessary to do so. But it is also clear that those banks and investment houses that are overexposed to high-risk loans must pay a price for their failure.

Domestic Slowdown Already Underway

The consensus among leading economists is that the subprime mortgage crisis will generate an economic slowdown during the first half of 2008. But opinions are mixed on whether the downturn would be severe enough to register two consecutive quarters of negative growth, the accepted definition of a recession.

An economic slowdown was probably already underway in the U.S. going into 2008 as a result of the global credit crunch triggered by the subprime mortgage meltdown that began last summer.

The credit meltdown was triggered by a wave of defaults on high-risk, subprime and adjustable rate mortgages with a devastating impact on the U.S. housing market. Consider this:

- Up to 750,000 home foreclosures were recorded in 2007;
- As many as 1,000,000 more home foreclosures are expected in 2008;
- Housing prices fell 6.1 percent from October 2006 in 20 large metropolitan areas, the biggest decline since 1941.
- New home sales plunged 9 percent in November. Over the past 12 months, new home sales nationwide have dropped by 34.4%, the biggest decline since 1991;
- The latest unemployment figures are up—now nearly 5 percent;

Situation Could Further Deteriorate

The situation could deteriorate further in 2008. Slumping home prices will leave some homeowners with balances on their mortgages that exceed the value of their homes. With credit now tightening on home purchases, the problems in housing could worsen, with unsold homes piling up, causing prices to decline even further.

The ripple effect of the housing decline is already being felt in other areas of the economy, such as home furnishings suppliers, the real estate industry, and manufacturers of wood products, furniture, glass, and hardware.

A downturn in the housing industry will not in itself be sufficient to trigger a recession, but coupled with $100-a-barrel oil prices, rising food costs, and tighter credit restrictions, the chances for a recession increase sharply.

That's because consumer spending makes up 71% of the U.S.A.'s GDP.

All signs are that after years of spending more than they earn, American consumers are maxed out and will be forced to reduce spending. An Associated Press study of financial data from the country's largest credit card companies showed that Americans are falling behind on their credit card payments at an alarming rate, with the greatest rise among accounts more than 90 days in arrears.

Tools to Deal With Possible Recession in 2008 Limited

After seven years of deficit federal spending, a declining dollar and with an expensive war going on, the U.S. is poorly positioned to deal with an actual recession. Add to that the fact that the U.S. is entering a presidential election year with a divided and highly polarized government.

The usual remedies for dealing with a recession are to stimulate the economy with tax cuts and deficit federal spending and to reduce interest rates. But a series of federal tax cuts and a massive run-up in the federal deficit, due in part to an increasingly costly war in Afghanistan and Iraq, leaves the U.S. in no position to cut taxes or pump-up federal spending.

The Fed has already cut the interest rate three times over the past six months to stimulate the economy. Further reductions in the rate will very likely increase inflationary pressure and put additional downward pressure on the dollar's value.

Some say that a cheaper dollar would be healthy for the U.S. economy by making American products more competitive in the global market, thus providing a shot in the arm to the ailing U.S. auto, steel, machine-building, and electronic industries.

The problem with that is that there are 3.8 trillion U.S. dollars invested in international commerce, according to the International Monetary Fund (IMF). That means that a sustained significant decline in the dollar's value could precipitate a massive sell-off of dollars, causing even further declines.

The foreign holdings in dollars also could make the U.S. vulnerable to foreign policy pressures. Up to a trillion dollars are held by China alone and almost as many dollars are being held in Japan and Germany. The central bankers in those countries are sensitive to the negative impact the shrinking dollar has on the value of their holdings.

The dollar declined against the euro by 11% in 2007, according to the IMF, and has declined by 24% against a basket of 13 foreign currencies since 2006. There are signs that countries with large dollar holdings, like China, Japan, and the oil rich nations of the Middle East, are beginning to reduce their dollar holdings because of its shrinking value.

IMPLICATIONS FOR BUSINESS:

- In a 2008 recession or economic slowdown, debt will mean troubles; cash will be king; euros may trump dollars;
- If you have a healthy cash supply, look for bargains in mergers and acquisitions as troubled companies reach out for help;
- Expect Congress or the Fed to require greater transparency in derivative transactions and SIVs;
- If the economy and credit crisis worsens materially, expect Congress to step-up its search for villains—mortgage brokers, "greedy" investment banks, hedge funds, etc.—as a run-up to Election Day in November;
- Barring a dramatic change in the economy, look for continued investor uncertainty and market volatility for at least the first half of 2008.

THE 2008 PRESIDENTIAL ELECTION: A VOTE FOR CHANGE, BUT CHANGE TO WHAT?

In a presidential election year, a foundering national economy, coupled with a drawn-out, unpopular war, traditionally galvanizes an unhappy electorate to vote out those responsible for that unhappy confluence of events at the first opportunity.

But it's a long time between now and November, and the 10 months until election day promise to be marked by heated political posturing and continued partisan bickering between the Republican administration and the Democratic Congress.

Meanwhile, don't expect much progress in ending the war in Iraq or avoiding the recession bearing down on the U.S. economy.

Regardless of how the presidential primaries and caucuses turn out and who the nominees for both parties are, this much can be said up front:

- With President Bush unable to run for re-election, the next administration, whether Democratic or Republican, will abandon Bush's foreign and domestic policies and strike out in new directions for America.

  This election is about <u>change</u> and the leading Republican candidates—Arizona Senator John McCain, former Massachusetts Governor Mitt Romney, and former Arkansas Governor Mike Huckabee—have in large measure joined Democrats Senator Hillary Clinton, Senator Barack Obama, and former Senator John Edwards in calling for a new direction for America.

The political landscape as we enter the 2008 presidential election year looks decidedly unfavorable to corporate America.

Americans voted for change in the 2006 off-year Congressional elections by giving the Democrats slim majorities in the House and Senate. But President Bush and the Republicans in Congress have stymied Democratic efforts to make meaningful change in ending the war in Iraq or shoring up the domestic economy.

However, judging by the polls and the results of the Iowa presidential caucus and the New Hampshire primary, American voters appear determined to end the political stalemate and change the direction of the country.

Messages of "Change" and "Bringing America Together"
Resonate Well, But Can The Candidates Deliver?

On January 3, Iowa Democrats gave the nod to Illinois Senator Barack Obama, a youthful African-American candidate who promised to bring Americans together—Republicans, Democrats, and Independents—behind a program of change. It was an upset victory over the high-flying front-runner Hillary Clinton, who promptly re-gained equal footing with an unexpected win in New Hampshire.

On the Republican side, little-known former Arkansas Governor Mike Huckabee, a one-time Baptist minister, won by running as an outsider pledged to govern as a unifier by ending the political and religious polarization that has plagued Washington for the past decade or more. Again, Huckabee upset the more GOP establishment candidates Romney and McCain.

In the New Hampshire primary five days later, the tables were turned in both parties as McCain, whose campaign had been lagging, upset Romney and handily defeated upstart Huckabee, and Clinton, as noted, stunned pundits and pollsters by coming back to defeat Obama, with Edwards finishing well behind in third place.

While change is certainly on the minds of the voters, with more than two-thirds of them stating that the country is heading in the wrong direction, the mantra of change is more helpful to the Democrats, particularly Obama, who coined the slogan “time for change.”

Victories in Iowa and New Hampshire Don’t Always Ensure Success in the End

It’s well to keep in mind that Iowa and New Hampshire are small, rural, predominately white, Christian states, not at all representative of the rest of America.

Democrats Gary Hart in 1984 and Paul Tsongas in 1992 won as non-establishment candidates calling for “change” in early contests in Iowa or New Hampshire, only to lose out in the race for their party’s nomination to more established party candidates in later races. The same was true of Republicans George H. W. Bush in 1980, Bob Dole in 1988, Pat Buchanan in 1996, and John McCain in 2000.

Obama is under considerable pressure to spell out precisely how he plans to bring about unity and bi-partisan support for change in the badly fractured American electorate.

He will also have to flesh out his plans on how he hopes to convince Republicans and conservative Democrats to give up enough ground so the nation can move forward for change on such divisive national issues as healthcare, immigration and energy policies, and ending the wars in Iraq and Afghanistan.

The fact that he is essentially in sync with the mainstream Democrats on key issues should work in Obama’s favor as he battles for the party’s nomination.

With still a long way to go in the primary process, we rate Clinton’s chances of winning the Democratic nomination at 60-40, Obama’s at 40-60, and Edwards at 20-80. On the Republican aide, McCain is clearly the front-runner, trailed closely by Romney, with Huckabee a distant third. As the contests move to the larger, more demographically diverse states, Huckabee’s strong base in the party’s conservative religious right becomes less of an advantage. In many of the larger more diverse states like New York, California, Florida, Michigan, Massachusetts, New Jersey, Pennsylvania, Illinois and Ohio, it becomes a liability.

The Possibility of a Third Party Challenge By New York Mayor Mike Bloomberg

Because of Republican dissatisfaction with the party's list of candidates and the large upsurge in the expected independent vote, there has been speculation of a possible Third Party candidacy by New York Mayor Mike Bloomberg.

Bloomberg, a billionaire several times over, and a former Democrat who turned Republican to run for the mayor's position, had earlier seemed a strong draw to independent voters and to dissatisfied Democrats and Republicans alike. But as the candidate field in both parties has narrowed down to a smaller group of generally well-qualified candidates, talk of a Third Party challenge quieted. If the Republicans had seemed poised to nominate an ultra-conservative from the religious right like Huckabee, chances were that large numbers of independents and moderate Republican voters might be tempted to shift to Bloomberg.

At this writing it is impossible to predict who the Democratic and Republican nominees will be. But because of the front-loading of primaries and caucuses this year, the successful nominees should be known after the February 5th Super Tuesday results are in from the 23 state primaries and caucuses scheduled for that date.

If Bloomberg is to enter, it will likely happen in late February or early March.

Whomever the Two Major Parties Nominate, The Democratic Ticket Will Be Favored

But whomever the parties' presidential and vice presidential nominees may be, odds heavily favor the Democratic ticket. Despite the pundits' insistence that presidential elections are not about the past, but the future, the fact is that the state of the nation at the time of the election is attributed to the party holding the White House, even if the incumbent cannot run for re-election.

Peace and prosperity have been the traditional surefire measure of success for the party in power. Neither is present today.

Much of the blame for the dismal state of the nation has fallen on President Bush, whose approval rating has hovered in the low 30s during the past year. But the public's perception of Congress has also slumped to all-time lows in the past several years, which hurts Republican Congressional candidates, the most since they were in control of both houses until the beginning of 2007.

IMPLICATIONS FOR BUSINESS: Even if the Republications manage to hold on to the White House in November, the mantra of "change" voiced by nearly all of the candidates of both parties mean just that. That also means the strongly and consistently pro-business policies of the Bush Administration are due for some medication in areas such as trade, regulation, and tax breaks—much more so, if the Democrats prevail. In other words, be prepared.

DEMOCRATS LIKELY TO INCREASE HOLD ON CONGRESS AND MAINTAIN THEIR LEAD IN GOVERNORSHIPS

With all 435 House seats up for election in November, the Democrats can be expected to pick up at least 10 seats. That would give the Democrats a majority of 242 to 193, bringing their lead from 29 to 39 or more.

On the Senate side, 34 of the 100 seats are up for election. In addition to the tide running heavily in their favor, the Senate Democrats have another big advantage. Of the 34 seats at risk, 22 are held by Republicans and only 12 by Democrats.

The Democrats currently have a very slim 51 to 49 edge in the Senate, with two of the 51 seats actually held by Independents who caucus with the Democrats—Joseph Lieberman of Connecticut, and Bernard Sanders of Vermont. Experts predict that Democrats will make a net gain of from four to six seats, increasing their majority, but still short of the 60-vote mark needed to cut off filibusters.

There will be governors' races in 14 states, but experts are predicting a wash, leaving intact the current political lineup of 28 Democratic and 22 Republican governors.

IMPLICATIONS FOR BUSINESS:

- Don't look for any major legislative initiatives in this presidential election year. The economy is in a slump, the budget is in the red, and political polarization is at an all-time high;
- The Democrats' efforts to finance tax cuts for the working poor and middle class or to launch major new spending programs for education or healthcare by closing business tax loopholes and eliminating tax breaks for the rich will be vetoed by President Bush;
- In the wake of the subprime mortgage meltdown, look for Congress to press for tightening restrictions on the sale of bundled mortgage-based securities by banks, mortgage lending firms, and investment banking houses;
- Congress will likely press the SEC to recommend regulation of derivative investments, hedge funds, and private investment banking firms;
- The economic slowdown will present acquisition or merger opportunities for cash rich corporations;
- The declining economy may spur business to tighten up operations by cutting costs, encouraging efficiencies, and deferring expensive new projects.

THINK ABOUT THIS:

According to the Director of National Intelligence,
U.S. spending on intelligence totaled $43.5 billion in 2007,
by some 16 different intelligence agencies.

THE SILENT MAJORITY: STILL THERE, STILL POTENT

The phrase "silent majority" entered the modern political vocabulary in 1969 when President Richard Nixon used it to set up a contrast between most of the nation and the very vocal demonstrators, who were then loudly protesting his continuation of the Vietnam War. Many middle class Americans still backed the war and were appalled by images of protesters burning flags and waving pro-Viet Cong signs. The phrase gave them an identity and even the sense of a cause.

But "silent majority" was not new. In fact, the phrase was nearly a century old when Nixon appropriated it, appearing first in 1874 in an article in *Harper's Monthly* magazine commenting on a political upset in which the losing side "hadn't counted on the silent majority."

That's highly significant because mainstream Americans, who go quietly about their business and don't engage publicly with the media or express their opinions in other ways, have long been a potent factor in our society. And they still are.

Not Just Older Folk

In 1969, the silent majority was believed to consist mainly of the older generation (World War II veterans and the like in all parts of the U.S.), but it also described young people in the Midwest, West, and the South, many of whom did eventually serve in Vietnam.

Time has reduced the ranks of WWII veterans, of course, but the identity and location of the silent majority remain much the same, although precise data are difficult to obtain.

One large slice, though—as the presidential candidates are increasingly recognizing—is the NASCAR community. A NASCAR fan profile tends to confirm this. 61% are married with children; 60% have at least some college education; 72% are employed full-time in managerial, technical, craft or manual jobs. Their average income is $68,000, and 70% are homeowners.

There are now more than 80 million NASCAR fans, and they are spread across the nation: 20% live in the Northeast, 23% in the Midwest, 19% in the West, and 38% in the South.

What is very different from 1969 is that, while Nixon was able to rally the silent majority behind the Vietnam War, most of its members today oppose the war in Iraq. Public opinion polls consistently show that more than two-thirds of Americans disapprove of President Bush's conduct of the war and well over half now believe the invasion was a mistake. The percentages, not surprisingly, are much higher among Democrats and Independents, but more than one-third of Republicans also oppose the war.

The difference from 1969 to 2007, however, does not reflect a change in silent majority values. The shift against Iraq—like the shift against Vietnam that took place in the early 1970s—is simply a reaction against seeing American service people dying in someone else's civil war that we are not winning.

Values Remain Constant

Silent majority values remain what they always were—proudly patriotic, pro-family, pro-free enterprise, conservative on most (but not all) social issues, and pretty much middle-of-the-road in politics. The American political road has always had a lot of bends in it, though, and currently the curve seems to favor the Democrats. Much can, and will, happen between now and the November elections, but the trends indicate the silent majority is tilting quietly to the left.

According to a recent Pew Research Center study, "In 2002, the country was equally divided along partisan lines: 43% identified with the Republican Party or leaned to the GOP, while an identical proportion said they were Democrats. Today, half of the public (50%) either identifies as a Democrat or says they lean to the Democratic Party, compared with 35% who align with the GOP."

It's too soon to know if this is a lasting trend. Political scientists say that when someone votes for a party in two successive elections, he, or she, tends to stick with that party long-term. The difficulty for both major parties in recent decades has been getting voters to make that kind of commitment.

But there is one new factor that could play a historic role: Three-fourths of the public rate President Bush's job performance as unsatisfactory. For the silent majority, that may leave a lasting impression.

IMPLICATIONS FOR BUSINESS: Business leadership needs to quickly develop plans and policies that will generate silent majority support. Business leadership has been silent too long. Failure to do this will lead to a new era of fines and regulations that will be counter to current business goals.

ENERGY: THE LOOMING CRISIS

Since our first Trend Report many years ago, we have tried to alert our friends to the severe threat posed by our nation's lack of a coherent energy policy. We have continually warned that energy is the Achilles heel of the U.S. and that the future of our nation will depend on conserving and securing enough energy from a variety of sources to keep our economy functioning and our military able to protect us. Now the problems we face go far beyond our borders. Indeed, they may be almost beyond our capabilities.

We may witness in the not distant future the proverbial immovable object meeting the irresistible force. Can we avoid a head-on crash between the dictates of the environment and the need for energy to keep the world as we know it functioning?

A Pentagon report mentioned in an earlier Trend Report projected that nations could become so desperate and key resources so scarce that "disruption and conflict will be endemic" and "warfare would define human life."

To make matters more complex, the world is entering a different energy era—that of a demand-led energy crises. Past energy crises were supply-related, caused by sudden interruptions in oil supplies—usually for political reasons. Future prices will be driven by demand from China, India, and other developing economies as they compete for their share of the energy pie with the developed countries. Political problems can be solved. The demands of billions of people are difficult to thwart.

The challenge is to choose, harness, and balance solutions before civilization as we know it, falters and begins to fail. We have only decades to save what took centuries to create.

The first step is to acknowledge that there is no silver bullet. There is no simple technological or miracle solution waiting in the wings.

The next step is to recognize that every little bit helps—fossil fuels, renewables, synthetics, hydrogen, ethanol, nuclear, etc.

Some solutions have their own problems. Ethanol, everyone's early favorite, seems to be proving there is no simple solution. A report by the Organization for Economic Cooperation and Development called on industrialized countries to eliminate ethanol subsidies, noting that they were "driving up food costs, threatening natural habitats and imposing other environmental costs." Ethanol, as a quick fix, needs to be fixed.

Conservation has an important and immediate role to play. The recent energy act increased vehicle fuel economy standards for the first time in 30 years and required a significant increase in biofuel production. The act also avoided putting a windfall profit tax on the energy companies at a time when the nation desperately needs additional energy sources.

At present, less than 10% of U.S. energy use is supplied by renewable resources. Unfortunately, projections for the year 2030 still place renewable usage at below 10%.

Untapped Offshore Sources

We have plenty of energy in America, but current government policy restricts access to 85% of potential offshore oil and natural gas development sites off the coasts of the lower 48 states. Arctic National Wildlife Reserve, ANWR, one of the largest and most promising oil and gas sites in the world, has been off-limits for years.
A new "Cold Conflict" could break out at the North Pole. With the melting of the sea ice, Russia and Canada have already planted or floated their flags and made clear that they consider parts of the Arctic Ocean as belonging to them. Will the U.S. sit back and watch other countries reap the energy harvest that might be crucial to bridging the gap between the fossil fuel era and the renewable era?

Russia, propelled by energy revenues, has emerged again as a political superpower. Could energy resources and capitalism eventually make Russia the ultimate winner of the "Cold War?"

Closer to home, there is a possibility that, by the year 2050, the U.S. will be only the third largest economy in the Western Hemisphere. Canada and Brazil could pass us by because they are, today, aggressively making the most of their energy resources.

And then there's China! 7918 Network is the name of China's massive highway project that will connect 250 cities and provide 1 billion people access to easy travel. That will trigger a real demand-driven oil crisis.

IMPLICATIONS FOR BUSINESS: Since energy is the dynamo that drives virtually all commerce, it doesn't take much to realize that a failure to begin finding effective, practical solutions to this most critical pending crisis will have a catastrophic effect on the entire U.S. business landscape.

THINK ABOUT THIS

Some 68 years after the European Holocaust and four decades after Cambodia's killing fields, well over 200,000 men, women, and children in Darfur have been slaughtered and at least 2.5 million others driven from their homes during 4-1/2 years of fighting, now spilling over into neighboring Chad. And the killing continues. So much for "Never Again!"

TERRORISM—WITH US MORE THAN EVER

The United States and Europe remain vulnerable to terrorist strikes. Indeed, thousands of terrorists lie in wait in world capitals.

However, al-Qaeda is clearly struggling to remain relevant, and Western intelligence is working overtime to eliminate or reduce terrorist threats.

On December 16th, al-Qaeda released a 97-minute message from their number-two—Ayman al-Zawahiri—titled "A Review of Events," aimed at galvanizing operations around the world. This and other broadcasts are supplemented by terrorist exploitation of the Internet second to none in the world.

Since 9/11, blogs, chat rooms, and websites have experienced a huge increase in popularity among terrorists—"cyber warriors," usually in their late teens or early 20s, who rail against the West. It remains to be seen just how effective these digital appeals in Egypt, the Sinai Peninsula, Indonesia, and elsewhere will be received.

The Taliban, al-Qaeda's allies in Afghanistan, remain active, but it is Pakistan—the global headquarters for al-Qaeda—where the real action is taking place. The Bhutto assassination is clearly the highest-profile event to date, but Pakistan is experiencing wave after wave of suicide bombings.

Saudi Arabia is clearly the major exporter of Islamist violence. Well over 3,000 Saudi citizens are roaming the world managing terrorist networks and executing suicide bombings and other attacks.

Between 20 and 30 Saudis intending to be suicide bombers cross into Iraq every single day. Several thousand more are there fighting, tasked with killing Americans and the Shiite Muslims they view as apostates.

More than 1,000 Saudis are currently training in an al-Qaeda camp in Syria. Indeed, more than 700 Saudi nationals are held in Iraq and another 100 in Jordanian jails, all of them charged with terrorist acts.

Experts tell us that the main funding source for every radical Islamist movement in the world today has Saudi origins.

Saudi power continues to grow and represents a huge financial influence in the region and around the world, as well as a significant lobbying presence.

IMPLICATIONS FOR BUSINESS: The next American president will need to use every possible diplomatic skill to keep terrorists reined in, while intelligence, law enforcement, military and other agencies address the issue. No one is safe.

NEW MIDDLE CLASS EMERGING AROUND THE WORLD

There has been huge growth in the middle class in China, India, Russia, South Africa, Turkey, Nigeria, Vietnam, Indonesia, Mexico, and Brazil. If politicians can create stability, look for these countries to compete vigorously on the world stage.

Some say the rise of China, India, and other nations will cause the U.S. to become a nation of low-paid service workers, perhaps destined for a high rate of unemployment. Note that every week for the past several years, nearly 1 million workers here quit or lost their jobs. But a slightly higher number were also hired in a typical week in administration, sales, finance, and business services. Healthcare is another booming sector.

- The number of individuals with net assets of at least USD 1 million, excluding their primary residence and consumables, in the world has increased 8.3 percent to 9.5 million;

- The number of high-net worth individuals with net assets of at least USD 30 million, excluding their primary residence and consumables, grew by 11.3% last year to 94,970;

- China and Russia were among the top ten countries with the fastest growing high-net worth populations. China's grew by 7.8 percent to 345,000 people and Russia's increased by 15.5% to 119,000. Brazil (120,000) and India (100,000) also showed significant growth.

IMPLICATIONS FOR BUSINESS: A new competitive edge is emerging around the world, but don't expect the U.S. to fall down. At the high end, there is serious money to be made from selling premium goods to this growing global wealth class and also a need to constantly redefine what constitutes luxury. When millions have access to the same premium goods, many of these offerings lose their value and cachet.

THINK ABOUT THIS:

Economic crimes in China rose 7.2 percent during the first nine months of 2007, to 59,000 cases, according to Xinhua, and included 6,187 financial fraud cases, 744 smuggling cases, up 15.9% and 13.8% respectively, and 1,758 intellectual property rights piracy cases, up 7.6 percent.

GIVING—MORE AND MORE

Americans are a generous people, historically noted for their philanthropies. These days, as the top rung of society enjoys record levels of wealth, philanthropic contributions have also reached dazzling heights. The billions donated by Bill and Melinda Gates and Warren Buffet are legendary and have set examples for many other of the mega-rich.

A short time ago, hotel tycoon Barron Hilton said he plans to contribute nearly his entire fortune, some $2.3 billion, to philanthropic endeavors. On the corporate side, investment banking titan Goldman Sachs, awash in profits, recently announced it was forming a special donor-driven charity fund with a target of $1 billion that will be financed initially by very substantial contributions from each of the firm's 350 partners.

Philanthropy used to be the province of the super-rich, but, over the past few decades, a new group of so-called "middle-class millionaires" has emerged, who've become significant donors. There are now some 8.4 million U.S. households with net worths between $1 and $10 million.

Americans—individuals, corporations, institutions, and foundations—contributed a whopping $295 billion to charities last year—75.6% from individuals. That figure is up some 65% from ten years ago.

Behind The Philanthropic Impulse

Individual generosity can be attributed to two overriding motives: an altruistic impulse to do some good by paying back, plus an understandable aversion to the ubiquitous taxman. For corporate givers there is yet another not insignificant benefit: enhancing a company's public image.

Recently, many companies have shifted to what has been called "strategic giving." Instead of a somewhat indiscriminate doling out of dollars, they are focusing on a few carefully selected projects that can make a meaningful difference for both the beneficiaries and the firm's reputation.

All this stepped-up largesse has, inevitably, raised some latter-day concerns. Accountability is one of the most visible new trends in philanthropy. Donors are requiring more transparency, more data, and better reporting. They want to know about actual results. They want to know exactly what their dollars are accomplishing—if the money is being spent wisely with a minimum of waste and overhead and, most importantly, no fraud. They are also taking a closer look at the handsome salaries of some of the executives running non-profits.

Fortunately, in this digital age, a number of websites have come online that provide objective information about non-profit groups to help potential donors make an informed evaluation before writing a check.

IMPLICATIONS FOR BUSINESS: Philanthropic activity, to a considerable extent, remains a function of the nation's overall economic performance. Although a short turndown next year might have some negative impact, the numbers will remain impressive, since many large foundations have never been better-funded than they are today. Moreover, this nation is now in the early stages of an unprecedented transfer of wealth. Over the next three decades, an estimated $10 trillion will be changing hands from one generation to the next. One can expect that a fair share of this huge pool of wealth will be channeled to philanthropic/charitable endeavors as well as to heirs.

THE WORLD IS GETTING OLDER

Last year, nearly 500 million people were 65 or older. By 2030, expect nearly one billion to be over 65—one in eight.

- For the first time in history, people age 65 and over outnumber children under age 5;
- Most countries show a steady increase in life expectancy and this should grow in the years ahead;
- People age 85 and over are now the fastest-growing portion of many national populations.

All this has led to changing family situations, new patterns of work and leisure, huge pressures on economic systems, and a totally new set of legal demands from this group.

IMPLICATIONS FOR BUSINESS: There are only a few years before the powerful influence of these demographic changes take hold. Look for new demands and pressures from this older group, requiring business to adjust in everything from its marketing and hiring practices to its healthcare programs and training or retraining.

UNEXPECTED GROWTH:
The Increase in Federal Subsidies Under Both Major Parties

The number of federal subsidy programs has reached 1,776—not good news for those who favor smaller government.

But whatever one's views on the role of government, the real significance of the figures is the way it illuminates the continual growth of subsidy programs through both Democratic *and* Republican administrations.

In 1970 the number of federal subsidy programs stood at 1,019. The level rose and fell somewhat for the next 15 years, reaching a low of 1,013 in 1985, reflecting President Ronald Reagan's attempt to shrink the size of government. The numbers rose steadily after that:

- 1,176 in 1990
- 1,390 in 1995
- 1,425 in 2000

That period covers the last three years of Reagan's administration, when the number of programs began to rise again, four years of Bush 41, and eight years of Bill Clinton. Contrary to popular assumptions, the growth was actually smallest under Clinton.

Most significantly, the number of subsidy programs has shot up dramatically under Bush 43—an increase of 351 in just seven years to hit the historic 1,776 mark. Ironically, during the first six of those seven years, Congress was controlled by Republicans.

IMPLICATIONS FOR BUSINESS: Take with several grains of salt any and all campaign promises to shrink the size of government by ending programs for special interests. Such talk is no more credible coming from the Republicans than it is from Democrats.

THE UNITED ARAB EMIRATES:
FROM WASTELAND TO ECONOMIC POWERHOUSE

The War for Development

Visit Dubai and prepare to be stunned by one of the fastest-growing cities on the planet. With a skyline filled with construction cranes, the United Arab Emirates' booming commercial center boasts more shopping malls per capita than anywhere in the world.

Dubai's economy is growing at 16% a year—about 50% faster than that of China's. The city-state has emerged as the New Silk Road—the growing trade and business corridor between the Middle East and Asia. The rising fortunes of China and India, the economic incompetence of Tehran (a more natural Silk Road), and a Middle East awash in investment petrodollars combine to ensure Dubai will continue as the region's financial services, trade, and tourism hub.

No wonder Goldman Sachs, the Carlyle Group, and Microsoft are rushing in.

But Dubai is only the sharp end of a larger phenomenon–-one that some observers describe as a "regional war for development." After decades of neglect and stagnation, this region of the Middle East is emerging as a noteworthy turnaround story in the global economy. Powered by market reforms and growing investment volumes, it and North Africa expanded more than 5 percent in each of the past three years, according to the World Bank.

Oil-producing states earned some $1.5 trillion in oil revenue between 2002 and 2006. Unlike the late 70s and 80s when oil wealth was squandered on white elephant projects and Bond Street shopping sprees, investment is pouring across national borders. The region's stock and debt markets are expanding—partly thanks to innovations in Islamic finance. That allows capital to flow from places that have it, like the oil-rich emirate of Abu Dhabi, to many (although not all) of the neighboring countries that need it.

Cross-Border Deals

Cross-border mergers, unheard of not long ago, are becoming fashionable. In March, Qatar Telecommunications Co. agreed to pay $3.7 billion for a 51% stake in Kuwait's national Mobile Telecommunications Co., which operates from Iraq to Saudi Arabia and Algeria. Private-equity firms are proliferating, raising billions of dollars designated for the region. HSBC estimates one-third of global investment devoted to project finance is earmarked for the Middle East.

Governments that once embraced Marxism are now actively courting foreign investment as a way to diversify their economies, create jobs, and forge strategic business relationships.

Overall, foreign direct investment in the Arab Middle East reached $19 billion in 2006, up from $4 billion in 2001, according to the IFC.

Consumer spending is also soaring and consumer confidence is at near all-time highs in countries such as Saudi Arabia, Kuwait, United Arab Emirates, and Qatar.

While the war in Iraq and Iran's saber-rattling continue to dominate headlines, some neighbors are quietly adopting Dubai's largely apolitical economic model—setting up free-trade zones, cutting taxes, creating industrial "cluster cities," and undertaking huge real estate and infrastructure projects designed to lure tourists, trade, and investment.

To be sure, the region still presents many risks for potential investors. If the U.S. were to suddenly pull out of the region, Middle East investment could likely vanish overnight and hard-won economic and political gains be lost for generations.

That would be a disaster for the 300 million people who live in the Middle East. Half are under the age of 20 and most are ill-equipped to join the modern workforce. Without continued political and economic reforms, the next generation will be lost. Middle Eastern economies will need average annual growth rates of upwards of 7 percent just to create the 80 to 100 million new jobs needed by 2020.

IMPLICATIONS FOR BUSINESS: The Middle East is at a crossroads. The region can either continue to make great strides as a new player in the global economy or return to its former inconsequential status. The outcome will be determined in no small measure by the foreign and trade policy decisions of the next U.S. administration.

THE GCC—A FORCE TO BE UNDERSTOOD

The leaders of the six Arab nations that form the Gulf Cooperation Council, who gathered in the Qatari capital of Doha in December for a two-day summit, tried valiantly to tackle two thorny issues—how to deal with the precipitous decline of the value of their dollar holdings at a time of unprecedented high oil revenues; and how to deal with a non-Arab guest that they themselves invited for the first time at such a traditionally Arab gathering—President Mahmoud Ahmadinejad of Iran.

They did, however, succeed in announcing the long-awaited launch of their equivalent of a European Common Market on January 1. The GCC Common Market, in principle at least, is the biggest economic bloc in the Middle East and Africa. The six GCC countries have a combined GDP of $800 billion, and they sit on nearly 5 trillion barrels of crude oil and 41.55 trillion cubic meters of natural gas reserves. For foreign investors, the Common Market offers enhanced opportunities of regional projects in both the private and public sectors. There is potentially more trade and more efficient investment. But the GCC countries are still essentially raw-material exporters despite some diversification. Intra-GCC trade accounts for only around 7 percent or so of the total. In the case of the European Union countries, the figure was two-thirds of the total before economic unification.

The GCC Common Market has its supporters as well as skeptics. Trades of goods and services have already been liberalized under the GCC customs union, which was launched in 2003, though it is not yet fully implemented. This makes the GCC more attractive as a destination for exports, although one should keep in mind that the GCC's GDP is roughly equivalent to the Netherlands—hardly a mass market.

Although Iran qualifies as a Gulf state—and is also an Islamic country like the six GCC members, Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates—Iran had never before been asked to attend a GCC meeting since its formation in 1981. Iran is almost totally a Shia state, while the populations of the GCC countries are largely Sunni, but Iranian émigrés constitute significant trading and mercantile constituencies in nearly all of them. (In the U.A.E., for example, some 500,000 of the country's 4 million people are of Iranian origin.)

Trade Issues Loom

On Iran's side, trade will be an issue that Ahmadinejad is likely to bring up in the coming months. Iran has proposed a regional free-trade pact with the GCC. Of Iran's global exports of $100 billion annually, about $2 billion go to the U.A.E.—mostly agricultural products—while Iran imports more than $10 billion worth of electronic and other manufactured goods from the U.A.E., mainly through Dubai. Iranian officials have said that Iran has invested more than $120 billion in the U.A.E. economy through various entities. But since Iran, like most of the GCC countries, is primarily an exporter of crude oil and natural gas, it is difficult to see how a wider trade arrangement can be fashioned that would benefit both sets of players. GCC countries have very little by way of indigenous manufacturing; their outbound non-oil trade tends to consist mainly of re-exports.

Still, if the U.S. and the European Union impose economic sanctions on Iran because of its nuclear program, Iran may seek to import more goods from the GCC countries. Whether they would agree to enhanced trade is an open question because all of them are closely allied with Washington, military and economically. They may feel diffident about doing an end run around Western-imposed sanctions. Of course, goods can always be smuggled across the Persian Gulf to Iran.

IMPLICATIONS FOR BUSINESS: The area covered by the GCC common market offers new opportunities. But be careful on several fronts, as business in the GCC is done differently than in every other part of the world.

SOVEREIGN WEALTH FUNDS MARCH ON

Sovereign wealth funds, huge cash pools controlled largely by developing governments—many, oil-rich—have been around since 1953 when the Kuwait Investment Authority was established. Recently, however, U.S. equity markets have been galvanized by unusually big-bucks investments in a number of giant U.S. banks reeling from the subprime mortgage and credit crises.

Inevitably, such moves have generated controversy among policy-makers and others concerned about potential risks to the nation's security and any unknown motives behind these investments. Fears have even been voiced that their objective is to gain control of international capital markets with some clearly strategic buys. Government funds, critics argue, unlike those run by private-sector firms, could very well have military or foreign policy motives behind their investments. The managers of these funds insist, however, that their investments are passive and they simply want to get better returns on their swollen currency reserves than now provided by U.S. Treasury bills.

It wasn't too long ago that a backlash from Congress sunk a proposed deal by a Dubai company to take over management of several U.S ports. Earlier, a state-owned Chinese oil company's bid to buy Unocal also came a cropper, yielding to political pressures.

Cash Inflows Welcomed

On the other hand, these cash inflows are providing welcome relief to battered banks eager to rebuild their capital bases after taking unprecedented write-downs. The concern is that the funds might take a controlling interest in the entities they invest in. With rare exceptions (Citgo, for example, acquired by Venezuela), that hasn't happened.

Undaunted by a problematic $3 billion investment in the Blackstone Group, LP, which has since lost almost a quarter of its value, the state-run China Investment Corporation recently poured some $5 billion into Morgan Stanley, giving it a 9.9 percent stake in the firm. Citic Securities Inc., another Chinese sovereign fund, took a $1 billion position in Bear Stearns.

In November, the Abu Dhabi Investment Authority in the United Arab Emirates came up with $7.5 billion for Citigroup. Merrill Lynch, facing billions in additional mortgage-related write-downs in the just-ended 2007 fourth quarter, agreed to sell $5 billion in new stock to Temasek Holdings, Pte. Ltd., a Singapore, state-owned investment company. Another Singapore sovereign fund, the Singapore Investment Group, invested $10 billion in the Swiss-based UBS, which has major operations in the U.S.

Not only American firms have been targets. Among others, the Kuwait Investment Authority has a 7.2 percent stake in Germany's Daimler auto empire, representing an investment of $8.1 billion. Abu Dhabi invested $5 billion in the Prime West Energy Trust of Canada, and Temasek laid out $3 billion for 12% of the U.K.'s Barclays banking operations.

The rapid growth of sovereign wealth funds, and their sudden higher visibility here, owe a great deal to the massively lopsided U.S. global trade deficit as we continue to ship vast quantities of dollars overseas in payment for foreign goods. U.S. petrodollars have been piling up in oil-producing nations, particularly, since such sales are usually denominated in greenbacks. Some estimates now place the total current worth of such funds at an astronomic $7 trillion, which could grow to $12 trillion by 2015.

Ironically, these funds are using the rule of law to capture these positions when, in other pursuits, the law is ignored.

IMPLICATIONS FOR BUSINESS: Despite the nay-sayers, in today's globalized investment world, look for sovereign wealth funds to increasingly use their dollars to take significant positions in American companies—and not only in the financial services sector. Policy-makers may be concerned, but no one on Wall Street appears to be complaining.

AN ALTERNATIVE LOOKS FOR ALTERNATIVES

As the pipeline for big deals in the West continues to contract, private equity—a mainstay of the "alternatives" asset class—is looking to beef up efforts to invest abroad in 2008. One unlikely beneficiary of that trend, and a prime example of just how far afield private equity is ranging these days: Africa.

That continent's long-standing corruption and instability notwithstanding—the events in Kenya are but the latest example—private equity funds are moving on several fronts to invest in Africa in a bigger way.

In December, Blackstone agreed to spearhead an $872 million dam project near Lake Victoria in Uganda. In September, Ethos Private Equity and Goldman Sachs agreed to buy South African casino operator Gold Reef Resorts for $1.37 billion. In April, Bain Capital completed a $3.5 billion buyout of South African jewelry retailer Edcon—the biggest buyout in that country's history. Late last year, Carlyle raised a $1 billion fund for foreign acquisitions in, among other areas, North Africa.

Indeed, private equity funds investing in the Middle East and North Africa grew to $5.2 billion in 2006 from just $316 million in 2004. Another bit of anecdotal evidence: two top dealmakers and the heads of Europe, Middle East, and Africa operations at their respective investment banks (Credit Suisse and JP Morgan) were lured to big private equity funds (Ripplewood and TPG Capital) in 2007 in large part to advance their PE firms' investment goals in those regions.

Why is Africa suddenly so appealing to Western investors? Three reasons. One, cell phones have transformed the daily life of many rural citizens in Africa, bringing them into contact with the outside world and leapfrogging inherent infrastructure problems. Two, African countries' trade with China has grown at a 40% per year clip since 2002, reaching $12 billion in 2006—a total expected to double in 2007 after a state-owned Chinese bank's $5.4 billion purchase of a 20% stake in South Africa's Standard Bank. Three, endemic corruption problems may be on the wane. Botswana, South Africa, and Ghana all scored better than India and China on Transparency International's 2007 Corruption Perceptions Index.

IMPLICATIONS FOR BUSINESS: Middle-market and smaller private equity deal volume will continue to be robust in 2008, but these funds will also shift more investments into emerging economies. Africa may be the most extreme example of this global recalibration, but it is not the only one. Some $3.7 billion in private equity funds had been raised as of November to target Latin American investments, the largest amount of capital raised for that purpose in a decade.

"HOME-BIAS" IS HISTORY

2008 may well be remembered as the year in which the reality of the market finally caught up with years of talk about globalization.

For more than a generation, domestic stocks dominated the portfolios of U.S. pension funds and other large institutional investors. In 2007, however, many of the country's largest pension funds announced that they were reducing historic "home-bias" by pulling assets out of U.S. stocks and shifting them to international equities.

On December 17, the board of CalPERS—the nation's largest public pension fund—decided to add $24 billion of its $250 billion in assets to an international equities portfolio that already held some $46 billion. The move was part of a broad strategy shift that left the fund's equity holdings evenly divided between U.S. and international stocks. In making the change, CalPERS was following the example set by the Washington State Investment Board ($71.4 billion), the Massachusetts Pension Reserves Investment Management Board ($54.2 billion), and several other large pension funds that have shifted their equities portfolios to a 50-50 split between U.S. and international investments.

Overall, more than $100 billion in institutional assets exited the U.S. market during the year ending June 30, 2007. Many of these dollars were reinvested in non-U.S. stocks: International equities were expected to grow to 30% of U.S. institutional investment portfolios by the end of 2007, from 25% in 2006. The flow of investments out of U.S. stocks and into the rest of the world will likely accelerate in 2008 because:

- Economic growth rates in Asia and other parts of the world are far surpassing those in the U.S.;
- Institutions have embraced diversification as their central investment strategy;
- Regulatory differences between country markets—especially those in Europe and the U.S.—are narrowing;
- Technology has made cross-border business and investing commonplace and made information on foreign markets easily available;
- The recent out-performance by international stocks is beginning to attract individual investors; international equity allocations in U.S. 401(k) plans increased to 10% at the start of December 2007 from 8.2 percent at the start of the year, according to consultant Hewitt Associates.

<u>IMPLICATIONS FOR BUSINESS:</u> The massive movement of institutional dollars represents a secular shift—one that investors must adjust for by eliminating or reducing the so-called home-bias of their own portfolios to the maximum possible extent. The short-term impact of the shift on publicly traded companies in the U.S. is less certain: The departure of U.S. investment assets for international markets will be offset to a large extent by inflows from foreign pensions and other overseas institutions now in the process of bringing global diversification to their own portfolios. Over a longer-term horizon, however, there is no doubt that markets are re-making themselves to reflect a globalized world economy in which investors can no longer afford the comfort of home bias.

A NEW WAY TO PLAY COMMODITIES?

Increases in commodities process and surging demand for raw materials were two of the most influential trends of 2007. The competition for commodities appears to be emerging as *the* dominant global economic trend of the future.

One of the truly dramatic stories of the past 20 years has been the movement of millions of people out of poverty in fast-growing countries such as China and India. However, as standards of living increase in these nations, so, too, does consumption.

People in the developed world currently consume 32 times the amount of resources consumed by people in developing countries. Consumption rates in China are still 11 times lower than those in the U.S. If the 1.3 billion people in China were to increase consumption rates to equal those in the States, global consumption rates would double. And that's just China. If the entire developing world were to catch up to the West, global consumption would increase eleven-fold.

The world's most sophisticated investors have already recognized these trends and are acting on them decisively. Many hedge fund managers and asset management firms have jumped with both feet into farmland/agriculture, including the likes of Blackrock, Schroders, and several of the world's largest hedge funds. Among institutional investors, U.S. endowments have been adding farmland to existing timber, oil, and gas and other commodities investments for the past several years, though the asset class remains a new one for most pension funds. All are being drawn in by a confluence of powerful factors:

- Demand for corn-based ethanol is surging based on rising oil prices and calls from world leaders to increase ethanol production and use;
- Food demand is rising rapidly in the developing world; China will likely remain a large and growing importer of grain for at least the next decade;
- Global warming threatens to disrupt existing agricultural production, leading to at least short-term spikes in prices.

Jim Rogers, an early advocate of agricultural commodities investment, believes that prices for agricultural goods—and therefore for farmland—will be boosted by the effects of global warming, which will disrupt production. Rogers predicts that the bull market for agricultural commodities could last for another 15 years, and is especially bullish on farmland in Latin America, which he thinks will not experience the water shortage he foresees for many other areas.

IMPLICATIONS FOR BUSINESS: While not many can actually start buying up Argentinean farmland, there are steps that prudent companies can and should be taking to protect themselves from rising materials costs or to take advantage of the new demand for commodities. Companies that have not developed universal purchasing programs to maximize buying power are leaving money on the table. Likewise, companies that have not begun working with an investment bank or global energy provider to develop hedging strategies for materials costs should pick up the phone. Corporate pension funds and other investors should be investigating opportunities in global commodities, energy infrastructure, and other sectors. One final intriguing possibility for investment banks: A market for the securitization of farmland.

THE SEC AND ALTERNATE SLATES OF DIRECTORS: STATUS QUO FOR HOW LONG?

In November, the Securities and Exchange Commission ended a year-long debate and voted that public companies could continue to disallow investors from proposing director candidates on corporate ballots. The debate was sparked by an unprecedented 34,000 comment letters to the Commission.

The SEC had been reviewing a proposition that would have permitted shareholders who owned 5 percent of a company's stock to propose by-law changes governing director elections. Another proposal would have excluded shareholders from advancing alternate candidates unless they were willing to undertake the expense of preparing and mailing out competing proxy statements. The 3-1 vote went along party lines, with the Republican commissioners, joined by SEC Chairman Christopher Cox, voting in the affirmative to block director nominees proposed by shareholders from proxy ballots. The only Democratic commissioner voted against the proposal.

The status quo decision is widely regarded as a win for corporations and business organizations which had lobbied to restrict shareholder access.

- Don't expect the SEC vote to put this issue to rest permanently. President Bush must still appoint Democrats to fill the two existing vacancies, and the Senate must ratify his selections;

- Commissioner Cox wanted to put the issue to a vote before the coming proxy season. Shareholder advocates, joined by large institutional investors (primarily socially responsible funds and union and pension funds) continue to clamor for more access to the corporate board nominating process.

- The American Federation of State, County and Municipal Employees has plans to test the ruling. AFSCME has asked JPMorgan Chase and Bear Stearns to permit all shareholders to vote on by-law changes to elect directors. If these two financial firms use the rule to deny access, AFSCME said it would seek legal remedies.

<u>IMPLICATIONS FOR BUSINESS:</u>

Proxy access has been a contentious issue for a long time. In the near term, the rule will hold. But a new administration, especially a Democratic one, may signal a softening toward shareholder rights;

Companies should be talking with major shareholders, particularly union and pension fund shareholders, on a regular basis to gain insight and show that their opinions are valued. That's not to say dialogue can preclude a proxy fight. But management should have a good idea how its board is regarded by its key stakeholders, who have little patience with underperforming directors these days.

THINK ABOUT THIS:

The number of prized, easy-to-remember, one-letter NYSE ticker symbols now unassigned is 10. Among the current single-letter designees, you'll find such household names as: Citigroup (C), Ford Motor (F), Kellogg Co. (K), Macy's (M), Sprint Nextel (S), Qwest (Q), U.S. Airways (U), U.S. Steel (X), and AT&T (T).

IRAQ—STILL A TICKING BOMB

President Bush's troop surge has tamped down violence in Baghdad and some other regions of Iraq, restoring trade, travel, and cautious hope in those areas. The improvements are due not only to the increase in U.S. manpower, but also to recently formed alliances with Sunni tribal chiefs, who have decided to restore peace in their neighborhoods by joining forces with the U.S. against al-Qaeda.

Despite such encouraging news, there is no cause for celebration. Dangers still loom:

- Al-Qaeda remains an elusive and determined fighting force. Many of its guerrillas have regrouped in northern Iraq, compelling the U.S. to shift troops and resources there in a seemingly never-ending search;

- The main purpose of the surge was to buy time for the central government to resolve the deep divisions in Iraq, including power-sharing among Shiites, Sunnis, and Kurds and a fair distribution of oil revenues. That has never happened. Quite the opposite has. Prime Minister Nouri al-Maliki and his fellow Shiites have used the respite to consolidate their control, ensuring that the bitter three-way division of the country will continue indefinitely;

- The surge, which is now in its 12th month, is a temporary measure because of the strains it places on the U.S. military. Defense Secretary Robert Gates hasn't said when withdrawals will begin, but troop levels will have to come down sometime in the next few months—with unforeseeable consequences;

- The U.S. has managed so far to dissuade Turkey from launching full-scale military operations in northern Iraq, an area that Kurdish separatists known as the PKK use as a staging area for terrorist attacks into Turkey. The situation remains volatile, however, with a simmering potential for serious warfare.

<u>IMPLICATIONS FOR BUSINESS:</u> Iraq continues to be the Middle East's tinderbox. It will be a major factor in the presidential election as the candidates argue over policy and jockey to exploit public passions. Keep a sharp ear on what they say, because much of the future of America's foreign policy in that region will be shaped by these debates.

INDIA ON THE RISE

The cliché that the economics of a nation is almost always shaped by its politics is being played out in India, where the systemic reforms that led to impressive annual growth rates over the last decade are in danger of being sustained only fitfully.

That's because the 14-party ruling coalition, headed by Sonia Gandhi's Indian National Congress, is uncertain whether its parliamentary survival is assured until the next national elections are held in May 2009. Foreign—and particularly American—investors keen to tap the growing Indian consumer market are unlikely to get clear signals concerning economic policy until the overall political picture becomes sharper.

There are two main reasons for the uncertainty in Mrs. Gandhi's Congress Party, which leads the coalition government that sits in India's 545-member Lok Sabha, or the Lower House of Parliament.

One flows from the fact that last month the Congress lost two key legislative elections to its major foe, the Bharatiya Janata Party (BJP). In both states, the BJP won by a landslide.

A Re-Energized BJP

The election victories will undoubtedly re-energize the BJP, which had led the national government until 2004 for a five-year period. It expedited liberalization of the economy, jettisoning the Fabian Socialism that successive Indian governments adopted since independence from the British in 1947. Building on foundations laid by an earlier Congress-led government, the BJP attracted more foreign direct investment. And it encouraged the growth of technology and business-outsourcing, sectors that have propelled India into the ranks of the world's top eight economies. But hubris prevailed among BJP leaders during the 2004 election campaign, and the more secular Congress Party unexpectedly returned to power.

The second uncertainty dogging Mrs. Gandhi's ruling coalition concerns India's Communist parties. They have fewer than 50 members in the Parliament, and are not formally a part of the governing coalition. But the government would lose a vote of no-confidence—should one be demanded—if the Communists withhold their support. They are not particularly enamored of the Congress Party's increasingly market-oriented policies. They have also opposed badly needed reform of labor laws. And some Communist leaders have resisted foreign investment, especially from America, on the grounds that such investment expands Washington's economic and political hegemony in South Asia.

Be that as it may, India's trillion-dollar economy is likely to continue on a roll in 2008, albeit not at the rate of 9 to 10 percent that had been anticipated earlier. An annualized rate of 7 percent is more in the realm of the possible.

Moreover, the decline of the U.S. dollar will make Indian exports more expensive. It will also hurt the value of remittances from Indians working overseas, currently more than $30 billion annually. The dollar's decline obviously also adversely affects the strength of India's robust foreign-exchange reserves, currently estimated at more than $300 billion.

The Indian government has said that it plans to spend more than $500 billion over the next five years in strengthening the infrastructure. Overseas companies have huge opportunities here.

These companies—and investors interested in establishing job-creating manufacturing units in India—would also be well-advised to pay attention to the annual budget that will be unveiled in late February. Will there be more tax reductions for the corporate sector? Will there be tax incentives for foreign investors? Will the domestic retail sector be opened up to more foreign companies?

But the big question remains: What if the government falls before then? Current polls suggest that if a snap election is called, the BJP is likely to be the victor nationally. And that would mean an even more pro-business government in New Delhi.

IMPLICATIONS FOR BUSINESS: Tremendous opportunity, but keep an eye on political developments.

PAKISTAN—A NUCLEAR DAMOCLES SWORD

"There is a battle raging for the hearts and minds of a new generation. It is a battle for the future. The new generation will choose moderation or extremism; it will choose education or illiteracy; it will choose dictatorship or democracy; it will choose tolerance or bigotry; and it will choose peace or war."

-Benazir Bhutto
(1953-2007)

It's no exaggeration to point out that Pakistan is, today, one of the most potentially dangerous locales in the world. The only Muslim nation possessing nuclear arms—plus the missiles to deliver them—is threatened by ever-mounting violence and instability in the wake of former Prime Minister Benazir Bhutto's assassination, which dramatically changed the nation's political and economic landscape.

The frightening possibility that nuclear weaponry might fall into the hands of Muslim extremists has never been more real. Bhutto, whose strong democratic convictions led her to openly support the West's anti-terrorism line, may have signed her own death warrant as a result.

Equally unsettling and worrisome is the fact that Pakistan's neighbor and long-time adversary, India, is also a nuclear power. Both have been in an ongoing, 60-year-long struggle to gain control of Kashmir in the Himalayas that has already touched off three separate wars.

President Musharraf—the man President Bush supported and bankrolled to the tune of billions annually with the hope that he would contain the growing Taliban and al-Qaeda presence in the country's tribal-ruled northern provinces—has been largely a disaster. Musharraf's authority may be seriously challenged on February l8, when the re-scheduled parliamentary elections will anoint a new prime minister. Another ex-prime minister, Nawaz Sharif, has his eyes on the prize, but he is someone with a corruption-tainted past, who is no favorite of Washington.

Meanwhile, Bhutto's husband, Asif Ali Zardari, who now chairs her Pakistan People's Party (PPP), has warned that any government attempt to rig the elections will trigger massive street protests. But the future direction of the PPP, Pakistan's largest political party, without Bhutto's charismatic leadership, remains murky.

Both Taliban and al-Qaeda strength in the parlous northern tribe lands keeps escalating and spilling over to bordering Afghanistan. Unfortunately, much of the $5 billion provided by the U.S to combat terrorism has been used instead for weaponry designed to counter a nuclear-armed India.

Pakistan remains essentially a tribal state where local chieftains often have more power and influence than the central government in Islamabad. Meanwhile anti-American sentiment and jihadist support, already strong among Pakistanis, keeps growing. Pakistan is a place that should give all Americans genuine concern today.

IMPLICATIONS FOR BUSINESS: Surprisingly, despite the arms race in the sub-continent, the economy of Pakistan until now has been performing quite well, with a growth rate in recent years that reached 7 percent annually. But Pakistan's current political instability, the resurgence of the Taliban and al-Qaeda, and the nuclear powder keg do not bode well for potential investors. The investment that Pakistan needs from the U.S. and European sources is unlikely to be forthcoming until next month's election provides a clearer picture of the nation's capacity for democratic governance and transparency, its capacity to deal with the growing terrorist threat, and, most importantly, its ability to effectively safeguard that nuclear arsenal.

DELIVERY OF NEWS AND OPINION ENTERS A TOTALLY NEW ERA

How people get information and how the media offer opinion is shifting rapidly. American newspapers and magazines are in flux in many different ways.

Newspaper circulation has been in a decades-long slide, commonly at a rate of loss of 1-to-2 percent a year. Analysts see no immediate end in sight. General interest magazines have suffered similar losses. Overall, they were down 4 percent in 2006.

The Internet, blogs, cable television, and other free media are usually identified as the chief reason. Last year more people read the *New York Times* online than in print. Another factor is the rise of free-distribution tabloids, such as *Metro AM, The Onion, Epoch,* and *Village Voice*, in major media markets like New York, Chicago, and Boston.

The new technology available to all, such as handset devices, is extraordinary. Sophisticated cell phones, palm pilots, and mp3 players offer more and more services and possibilities for use. Every taxi cab in New York now has a screen on the back seat which provides free news, weather forecasts, maps, traffic updates, flight information, and more.

As for traditional media, continued dramatic cuts in editorial boards, editorial staff, and senior management have been widespread, while staffs of the web divisions are increasing.

One body of opinion in the newspaper industry holds that these combined pressures will cause all newspapers to become free within the next 20 years—perhaps sooner. One respected industry observer, Ken Doctor, has gone so far as to say: "The notion of readers paying for news is now obsolescent."

Ownership of major publications is in flux, too. Rupert Murdoch's News Corporation has acquired Dow Jones and its flagship paper, the *Wall Street Journal.* Chicago real estate executive Sam Zell has bought the Tribune Co., which owns, among others, the *Chicago Tribune,* the *Los Angeles Times*, and *Newsday.* And Knight-Ridder, once the second largest newspaper chain in the nation with 32 papers, was recently sold to The McClatchy Co., which promptly unloaded 12 of the papers.

IMPLICATIONS FOR BUSINESS: Look for change to become even more sweeping in the future due to a rapid transition in the delivery of news and information, in general, and the ways in which people communicate.

The future of conventional opinion journalism—especially in print—is uncertain. Adding to the uncertainty is the rise of the blogosphere, the Internet realm where tens of thousands of individuals offer their personal opinions on events great and small, occasionally, with surprisingly effective results.

THINK ABOUT THIS:

A DEADLY YEAR FOR JOURNALISTS

2007 has turned out to be the deadliest year yet for press people. Sixty-four were killed in direct connection with their work, up from 56 the previous year. Iraq alone accounted for 31 of those victims. Somalia was the second deadliest country for the media in 2007, with seven deaths. Journalists were, in fact, silenced in every region of the world last year, including Pakistan, Sri Lanka, Russia, Zimbabwe, Eritrea, Nepal, Burma, Turkey, the Palestine Territory, Peru, Kyrgyzstan, Haiti, and Honduras.

MOST POLLUTED

What follows is a list of the ten most polluted sites in the world:

- Sumgayit, Azerbaijan (Petrochemical Industry)
- Linfen, China (Coal Production)
- Tianying, China (Lead Mining, Processing)
- Sukinda, India (Chromite Mining)
- Vapi, India (Pharmaceutical and Pesticide Industries)
- La Oroya, Peru (Polymetallic Smelter)
- Dzerzhinsk, Russia (Chemical Weapons Manufacturing)
- Norilsk, Russia (Nickel Mining, Smelting)
- Chernobyl, Ukraine (Nuclear Power Plant)
- Kabwe, Zambia (Lead Mine, Smelter Slag Heaps)

IMPLICATIONS FOR BUSINESS: With growth can come dangerously toxic air and water pollution. The developing countries face serious problems with this, in part because corporations from developed nations are moving in to avoid environmental restrictions in their own countries. Farsighted leaders in business, the NGO sector, and government must grapple with this trend starting in 2008.

EXPECT THE TRANSATLANTIC ALLIANCE TO DEEPEN

Look for top business, political, and NGO leaders to seek ways to deepen the relationship between Western Europe and North America, which has deteriorated in recent years.

A subtle hum of discussion is underway, emphasizing that the future of the West, given the rise of India, China, and other parts of the East, will depend on strong Atlantic alliances.

The French and their new head-of-state, Nicholas Sarkozy, will play a major role here, but so, too, will Germany's Angela Merkel. Though both these leaders will advance their own nations, the real measure of their statesmanship will be their ability to transcend parochial interests.

Expect French and German business leaders to be very active in this area as well.

IMPLICATIONS FOR BUSINESS: Three important economic and political power regions have emerged worldwide—Europe, Asia, and the Americas. While they may be in competition, it will behoove American business interests to keep a foot in all three regions.

THINK ABOUT THIS:

There are approximately 6,000 languages spoken in the world today. But it is estimated that about every two weeks another language dies, taking millennia of human knowledge and history with it.

WHO IS DOING THE R&D TODAY? A WAKE-UP CALL TO THE U.S.

Consider this long litany of dismaying facts:

- By the end of 2007, China and India accounted for 31% of the total global pool of R&D professionals, up from 19% as recently as 2004;
- The share of U.S. post-doctoral scientists and engineers who are foreign, temporary residents has grown from 37% to 59% in two decades;
- In 2005, only four American companies were among the top 10 in receiving U.S. patents;
- The U.S. is in 22nd place in GDP devoted to non-defense research;

- The National Science Foundation indicates that it can now fund only one in five research proposals that it receives;

- During the past two decades, the number of engineers, mathematicians, physical scientists, and geo-scientists graduating with bachelor's degrees in the U.S. has declined by 18%. The proportion of university students achieving bachelor's degrees in these fields has declined by almost 40% during that time;

- The U.S. ranks 17th among developed nations in the proportion of college students receiving degrees in science or engineering, a fall from third place three decades ago. It ranks 26th in the proportion receiving undergraduate degrees in mathematics;

- Fewer than 15% of U.S. high school graduates have sufficient mathematics and science credentials to even begin pursuing an engineering degree;

- There are more temporary residents than U.S. citizens enrolled in graduate-level, information-technology pursuits in U.S universities;

- According to Department of Education statistics, the U.S. is graduating more visual-arts and performing-arts majors than engineers;

- The U.S. ranks 8th in the percentage of its citizens obtaining college degrees (in *all* fields);

- According to Nobel laureate Richard Smalley, by 2010, 90% of all scientists and engineers with Ph.Ds will be living in Asia;

IMPLICATIONS FOR BUSINESS: The U.S. is falling seriously behind and the price will be paid by our future economy.

THINK ABOUT THIS:

Forget hedge funds and oil futures. *Art is hot!* Maybe the best place to put your money is art works. Christie's and Sotheby's, the two major auction houses, sold $1.7 billion worth of art in 2007, a 24% rise over the previous year. As usual, the best sellers were Impressionists, post-Impressionists, and Abstract Expressionists. Mark Rothko is very hot now. One of his works sold for $34.2 million while Pop artists like Andy Warhol are now in the eight-figure category, which is extraordinary for works that recent. The art world is always a roller-coaster because it is so economy-sensitive. If there's a downturn in 2008, collectors and the auction houses could see those big sales drop off quickly. But that's not all bad. The buyer with a sharp eye (or savvy adviser) would be positioned to snap up works at moderate prices that can appreciate sharply in the next upturn.

HIGHER EDUCATION: A GLOBAL BUSINESS

Higher education enrollment is currently 132 million students worldwide, up from 68 million in 1991. More than 2.7 million students are seeking education outside their home countries—a 56% increase since 1999. Consider these factors:

- Six countries host 64% of the world's mobile students: the U.S. (22%), the U.K. (13%), France (10%), Germany (9 percent), China (6 percent and Australia (4 percent). Australia and the U.K. have seen large percentage increases in their international student populations, while the U.S. has seen a modest decline. However, the U.S. continues to host the largest number of international students (582,984 students in 2006/07), followed by the U.K. at 344,335 students;

- Newer host countries such as China are seeing rapid increases in the numbers of international students. Several other countries in the Asia Pacific region have stepped-up their efforts to internationalize and to attract more international students;

- The largest groups of international students come from East Asia and the Pacific (31%). Students from China represent the largest share (14%), followed by India, South Korea, Japan, and Germany;

- Sub-Saharan Africa has the highest outbound student population (6 percent) almost three times greater than the world average. North America has the lowest outbound ratio with only 0.4 percent;

- Fast-tracks to green cards (or their local equivalents) for graduates in the sciences, technology, engineering and math fields exist in Canada, England, France, Germany, and Scotland. In the U.S., a bipartisan group of senators has asked Homeland Security to extend the Optional Practical Training period for international students from 12 to 29 months to allow them to work in U.S. industry and research centers while waiting to change their visa status;

- The U.S. State Department issued an all-time high of over 591,000 student visas and made a record number of Fulbright grants to both visiting students and Americans for international study.

IMPLICATIONS FOR BUSINESS: Only a few countries will be able to respond to the huge future increases in demand for higher education, especially from the developing countries. Continuing to keep academic doors open helps countries advance in science and technology. A third of all of America's Nobel Prize winners in science were born in another country. 40% of all who earn Ph.Ds in science and 60% in engineering in the U.S. began their lives and careers elsewhere.

TECHNICAL/VOCATIONAL EDUCATION: NEW JOBS FOR THE NEW ECONOMY

There is compelling evidence that vocational/technical training is an essential ingredient to maintaining a nation's economic competitiveness. Community colleges now serve more than 11.5 million students at nearly 1,200 colleges and institutions nationwide.

- Community college students represent 46% of all U.S. undergraduates;

- According to UNESCO, worldwide, the divide between academic and vocational training is becoming more blurred. Successful practitioners require not only skills that are immediately applicable to work, but also a knowledge base that will enable them to adapt as products and production methods change;

- The nature of work-based training varies considerably across nations, with formalized apprenticeship systems less extensive in Asia and African nations than they are in Northern Europe;

- 39% of students who are first in their family to attend post-secondary school, and 45% of all first-time freshmen, attend community colleges;

- According to the Spellings Report on the "Future of Higher Education," nearly 40% of today's post-secondary students are self-supporting from age 24 and up, almost half attend school part time, one-third work full time, and 27% are parents;

- The Department of Health and Human Services is projecting a shortage of close to 1 million nurses by 2020. Half of the nurses starting their careers today, and the majority of other new healthcare workers, are educated at community colleges;

- Community college students also represent nearly 80% of all credentialed firefighters, law enforcement officers, and EMTs;

- Overall, community colleges award more than half a million associate degrees and more than 250,000 certificates each year;

- 95% of businesses and organizations that employ community college graduates say they would recommend community college workforce education and training programs.

<u>IMPLICATIONS FOR BUSINESS:</u> As old-economy jobs are destroyed or displaced by innovation and global competition, the knowledge economy is also yielding new occupations that require an integrated (practical skills plus an academic base) approach to learning, training, and skill development. Employers need a flexible, portable, and transparent system to provide these new abilities effectively. In the U.S., today, community colleges are the key component of that delivery system.

SOME MAJOR SHIFTS COMING

- By 2030, nearly 5 billion people, more than 60% of the world's population at that time, will live in cities (up from 3.2 billion last year). Most of this astronomic growth will take place in Asia.

  The largest cities in 2030:

Tokyo	-	38.7 million
Delhi	-	37.7 million
Lagos	-	33.1 million
Mumbai	-	32.4 million
Dhaka	-	32.3 million

- Measured in purchasing power, China will have the largest economy in 2030, 50% larger than the U.S. and twice the size of India. Germany, Brazil, Russia, the U.K., and France will not even reach one-tenth of China's size;

- Today, the U.S., Japan, and Germany are the largest economies. By 2030, they will be replaced by China, India, Japan, Korea, and Indonesia. In the next 20 years, expect India's economy to gain approximately 270%, China 240%, and Indonesia 200%;

- Global trade will rise from $13.6 billion today to approximately $50.5 billion in 2030.

<u>IMPLICATIONS FOR BUSINESS:</u> Tremendous opportunities in many parts of the world and intense competitive pressures on the developed world.

WEB 2.0:
NEW SOCIAL NETWORKS POWER IN THE MARKETPLACE

The definition of Web 2.0 is a matter of dispute among technology wizards and CEOs. However, one idea remains clear: The Internet's transformation into a participative, networked, online community will have major ramifications for business.

The social networking aspects of Web 2.0 in particular have become popularized due to highly publicized Internet sites such as MySpace, YouTube, Craigslist and Facebook.

This drive toward a more participative Internet already has had a major impact on the business, political, and cultural arenas. In the computing world, organizations that have embraced the principles of Web 2.0 have been able to quickly surpass their competitors. Google, in particular, can be viewed as the archetypal Web 2.0 player. Additionally, nine out of *Time Magazine's* "Top Ten Websites" of 2007 are built upon the tenets of Web 2.0, such as user-generated content, multiple interfaces, and social networking.

International corporations such as Coca-Cola, Bayer, and Disney have harnessed Web 2.0's concepts of interactivity and participation to spruce up their Websites—and their public image. Each now offers features such as online games, personalized response pages, and participative learning forums—tactics they hope will engage and educate young audiences. Online participation may ultimately translate into a long-term customer relationship with the younger population.

Web 2.0 is also changing the workplace with its tools for business practice, such as internal blogs, wikis, social search engines, and online document sharing. Employees now use these Intranet tools to reach out to one another for assistance; to form communities around projects and areas of expertise; to problem-solve collectively; and to capitalize on internal opportunities. Since the workplace is innately social, Web 2.0 tools enable employees to use their relationships and at-work network efficiently and productively.

On the political front, Web 2.0 has changed the nature of presidential races. Online groups supporting candidates through blogs and other online sources have captured Internet space, creating a chorus of opinions. Similarly, the openness of major news media to online participation from their audiences—whether in the form of website posts responding to specific articles or the contribution of self-made video content—has transformed reporting the news into a more interactive, participative event.

Some Doubts Raised

Silicon Valley entrepreneur Andrew Keen argues that "what the Web 2.0 revolution is really delivering is superficial observations of the world around us rather than deep analysis, shrill opinion rather than considered judgments." As more individuals have the capacity to bring their thoughts to a global forum, the line between amateur and professional will become increasingly blurred. Potential misinformation from questionable sources can have serious repercussions. Furthermore, the increasing violation of intellectual property rights threatens the economic and social principles guiding business innovation.

While the tools of Web 2.0 have the power to democratize, facilitate, and interconnect, they also have their risks—risks the corporate community seems increasingly willing to take for fear of falling behind in a dynamic new marketplace.

IMPLICATIONS FOR BUSINESS:

- Web 2.0 participation—both with respect to customer and employee Services—eventually will become an essential for any up-to-date business practice;

- The number of public forums (both for praise and criticism) will increase substantially. Using Web 2.0 tools smartly and to organizational advantage will become a business priority;

- Regulation and protection of intellectual property rights will increasingly rise to the forefront of the corporate agenda.

CLOSING QUOTE

"I can't understand why people are frightened of new ideas. I am frightened of the old ones."

-John Cage
U.S. Composer
(1912-1992)