34th Trend/Forecasting Report

The Future is Here…
Unfolding Before your eyes…
Don’t Get Caught

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OUTLOOK FOR THE GLOBAL ECONOMY

Barring a recession in the U.S., or a bizarre terrorist event of huge proportion, the prospects for continued, but somewhat slower growth of the global economy in 2007 look very good, particularly for China, India, South Korea, and the other "Asian Tigers."

The stunning growth in the Chinese and Indian economies and more moderate growth in the EU nations have taken some pressure off the U.S. as virtually the sole engine for global economic growth. Still, the United States' economy, with a GDP of more than $13 trillion, has an enormous impact on the global economy.

Consider this: According to estimates from the International Monetary Fund (IMF), the U.S. GDP of $13.2 trillion in 2006 was almost equal to the combined economies of all members of the European Union ($13.4 trillion). In fact, the U.S. GDP totaled more than the combined GDP's of the next four leading nations: Japan, $4.4 trillion; Germany, $2.7 trillion; China, $2.5 trillion; and the United Kingdom, $2.2 trillion.

As a result, a slowdown in the U.S. economy will exert a drag on global growth next year, particularly those nations running large trade surpluses with the U.S. like Japan. The IMF estimates that, as a whole, global growth will slow to 4.9 percent in 2007, compared with an estimated 5.1 percent for last year.

The impact will be greater on the richer developed countries. The Organization for Economic Cooperation and Development has reduced its forecast for its 30 mainly industrialized nations to 2.5 percent from a previous estimate of 2.9 percent, making it the lowest growth rate since 2003.

China and India are likely to continue growing at a torrid rate of slightly under 10%, with Japan, Asia's largest economy, starting to come back by growing at a 2 to 2.5 percent rate.

Most of the EU nations are expecting a growth rate of about 2.5 percent. Latin American economies are expected to do well in 2007, since most of them are big exporters of commodities such as copper, iron ore, soy and other food products, areas where prices are on the upswing.

IMPLICATIONS FOR BUSINESS:

- Look for slower U.S. growth in 2007, especially in home construction, home furnishings, and auto sales.

- Watch for any deepening in the housing slump that could slow economic growth ever further.

- Don't expect the Fed to drop interest rates unless the economy slips toward recession.

- Monitor closely the dollar's value against the euro, pound, and yen. Unfriendly countries with significant dollar holdings—Iran, Venezuela, and Russia—may dump dollar holdings in favor of the euro, thus precipitating a run on the dollar.

- Companies that do business globally need to be wary of excessive dollar holdings. The dollar is likely to continue to decline in value in 2007.

Two areas that will boom: healthcare and energy. Look for growth in technologies for clean alternative energy sources. Energy costs will continue to rise and pressure to reduce greenhouse gas emissions will continue to mount as the impacts of global warming become more apparent and more costly.

A DEMOCRATIC CONGRESS AND PRESIDENT BUSH: PROGRESS OR GRIDLOCK?

Sharp differences between the White House and the Democrats, who now control Congress, over the war in Iraq and over such key issues as the environment, taxes, healthcare, trade policy and many others, ensure that legislative progress will only be possible on the margins, despite best intentions for cooperation on both sides.

Don't expect the post-election promises of bi-partisanship emanating from the Democrats and from President Bush to hold.

Corporate America, notably the big pharmaceutical, oil and banking interests, should not look for any special treatment from the new Congress in view of the overwhelming support they accorded the Bush Administration and the Congressional Republicans.

This means big-ticket items of interest to business such as major reforms in Sarbanes-Oxley regulations, elimination of the estate tax and the alternative minimum tax, making permanent the phased-in tax reductions passed during the first Bush Administration, and extension of fast-track approval of trade agreements are probably dead in the water.

With the next presidential election now less than two years off and the campaigns already underway, the Democrats are trying to establish a record of accomplishment in areas of greatest concern to their main constituencies—the middle class, the working poor, and minorities, particularly African-Americans and Hispanics.

Senate Majority Leader Harry Reid's two-vote margin in the Senate and Speaker Nancy Pelosi's 30-vote majority in the House may make it tough to for them to win a simple majority vote in those two chambers, much less put together the two-thirds vote margin needed in both Chambers to override a presidential veto.

And many of the incoming Democratic committee chairmen in both the House and Senate know that in order to make progress, they need some support from Republicans and at least the acquiescence of President Bush.

The powerful liberal Senate committee chairmen like Edward Kennedy (Health, Education, Labor, and Pensions), Carl Levin (Armed Services), Joe Biden (Foreign Relations), Barbara Boxer (Environment and Public Works), and Patrick Leahy (Judiciary) plus Charlie Rangel (Ways and Means), John Conyers (Judiciary), Henry Waxman (Government Reform), John Dingell (Energy and Commerce), and David Obey (Appropriations) in the House have no easy task. However, having been rendered impotent by the conservative Republican Congressional leadership for 12 years and largely demonized by the Bush Administration, they are in no mood to play nice with the President and the Congressional Republicans.

With this in mind, Sen. Reid and Speaker Pelosi have set out an agenda that might be in some measure achievable. It will certainly generate attention. That agenda includes:

- Increasing the federal minimum wage from its current level of $5.15 per hour to $7.25. There is enough Republican support for this to ensure passage.

- Reforming the alternative minimum tax (AMT) by raising the threshold to $150,000 to relieve the burden on the upper ranges of the middle class who are now being drawn into its coverage. There is enough bi-partisan support for this to win passage. But there is less support for Democratic hopes of doing away with tax breaks for oil, or for an oil windfall profits tax, which in any event President Bush would likely veto.

In general, President Bush's tax policy agenda will be DOA with the new Congress. The repeal of the estate tax, making permanent the phased-in tax cuts approved during the President's first term, and totally eliminating the ATM will not see the light of day in the House Ways and Means Committee headed by Rep. Charles Rangel.

- A series of much stiffer ethics rules in response to the scandals that hurt the Republicans in the 2006 mid-term elections. One objective will be to limit the influence of lobbyists.

- Amending trade legislation to provide more financial support and job retraining to Americans who lose their jobs due to outsourcing. Also, removing tax incentives for American firms operating abroad and enforcing anti-dumping and anti-piracy of copyright and intellectual property provisions of the World Trade Organization's regulations.

  With protectionist sentiment running high among many of the newly elected Democrats, the President's chances of winning extension of fast-track authority for trade agreements when it expires next June are problematical.

- Extending the college tuition and sales tax deductions. The Administration and Republican lawmakers are likely to support a Democratic move to extend the tuition tax break that allows married couples with joint incomes of up to $130,000 to claim a $4,000 deduction for college tuition. There is also bi-partisan support to renew the deduction for payment of state income and sales taxes, which expired on December 31, 2006.

- Broad immigration reform that would include a guest worker provision and a means for undocumented individuals who have been in the country and worked and abided by the laws for up to five years to be eligible for American citizenship. Although conservative Republicans strongly oppose the so-called "amnesty" provision, President Bush, who strongly favors a guest worker program, would probably sign such a bill into law.

- Changes in the prescription drug assistance program for the elderly to make it less complex, less cumbersome, and less expensive. Although the President is likely to veto it, the Democrats would like to enlarge the program as part of an effort to move to a national health insurance system and to pass legislation permitting the government to negotiate with the pharmaceutical companies for the price of prescription drugs in the Medicare Part D program.

- Eliminate the current ban on federal spending for stem cell research. There will be enough votes to get such a measure through Congress, but the President will probably veto it.

- A long shot: Reinstating the military draft or perhaps a call for public service for young people. This idea has been floated by Charles Rangel and discussions are bubbling up in many arenas.

Even as the House and Senate try to push legislation through, the Bush Administration will be under intense critical scrutiny by committees in both Houses for its handling of the war on terror and the war in Iraq, including the NSA's warrant-less electronic surveillance program; and the torture of prisoners at Guantanamo Bay, in Iraq, and at secret CIA bases abroad.

There are also likely to be hearings on allegations of corruption involving no-bid contracts for construction and logistical services in Iraq; and cronyism, corruption, and incompetence in the Katrina recovery program as well as on hedge funds and perhaps private equity.

Another big roadblock to any major legislative initiatives, however, is the serious federal deficit problem that has accumulated during the Bush presidency.

With the total federal deficit approaching $9 trillion, there is little room for new spending. But Democrats may have come up with a novel way of curbing spending on existing programs by passing a continuing resolution when the new Congress convenes that would freeze most federal spending at last year's level until the current fiscal year ends on October 1.

The opening for such an unprecedented move was created when the Republicans adjourned Congress in December without approving most new spending requests, thus leaving virtually every domestic department dependent on a stop-gap spending bill due to expire February 15.

<u>IMPLICATIONS FOR BUSINESS:</u> The new Congress will not be business-friendly. A few examples:

- Big oil will be pressed to justify last year's record profits and will also have to fight off efforts for a windfall profits tax.

- Pharmaceutical companies may have to negotiate prescription drug prices on federally funded programs with the government.

- Tax advantages to multi-national corporations on profits made abroad will get intense scrutiny.

- Efforts to make hedge funds more transparent and to give the SEC authority to regulate derivative transactions may be launched.

THE RISING TIDE OF ANTI-AMERICANISM

The rising tide of anti-Americanism in Europe, the Middle East, and Asia poses an increasingly serious challenge to American policy makers and a potential threat to U.S. business interests abroad.

It appears little is underway to change this view, at least in the short term.

The surge in anti-American sentiment is particularly virulent in Arab and most of the other predominately Muslim nations where it is closely tied to the U.S. occupation of Iraq and American support of Israel.

A survey conducted in November by the Arab-American Institute in five Arab countries found that more than 80% of the people in Saudi Arabia and Egypt had negative opinions of the United States. In Jordan, negative U.S. ratings climbed from 62% to 90% over the past year and in Morocco the negative ratings rose from 64% to 87%.

But anti-Americanism is also on the rise in Europe, Asia, and Latin America among nations that have in the past have traditionally been considered friends and allies of the United States. The war in Iraq is seen as a major factor in the decline of U.S. prestige.

The latest Pew Global Attitude Survey of 17,000 persons taken last May in 15 countries including the United States showed that the U.S. was viewed favorably by a majority of persons in four of the countries: Britain, 56%; Nigeria, 62%; Japan, 63%; and India, 56%.

In the other 10 countries, less than a majority viewed the U.S. favorably. They included: France, 39%; Germany, 37%; Spain, 23%; Russia, 43%; Egypt, 30%; Indonesia, 30%; Pakistan, 27%; Jordan, 15%; Turkey, 12%; and China, 47%.

The Iraq War has Eroded Support For the War on Terrorism

In the aftermath of the 9/11 terrorist attacks on the World Trade Center and the Pentagon, there was an outpouring of global sympathy for the United States and general support for the war on terrorism, except for several Arab and predominately Muslim countries.

However, the U.S.-led invasion of Iraq, without the sanction of the United Nations, has greatly eroded that support. The Pew Survey found that the war on terrorism now draws majority support from just two countries—India and Russia. But even in India that support has decreased significantly over the past year from 65% in 2005 to 52% in 2006.

In most other countries, support for the war on terror is either flat or has declined. In Japan only 26% support the war on terrorism, down from 61% in the summer of 2002. Only 39% of Indonesians back the war, compared with 50% in 2005, and in Spain, which underwent a devastating terrorist attack two years ago, the war is opposed by 76%.

Anti-American Sentiment Impacts Other U.S. Foreign Policy Goals

Other U.S. foreign policy goals are also negatively impacted by the growing anti-American sentiment, as governments appear more reluctant to be seen as aligned to American interests. This has greatly complicated the Administration's efforts to line up multinational support for such issues as U.N. reform, intellectual property and copyright protection, and sanctions against nations for human rights violations.

The precipitous drop in respect for the United States was dramatically displayed at the opening session of the U.N. General Assembly last fall when delegates enthusiastically greeted anti-American invective delivered by Venezuelan President Hugo Chavez, Iranian President Mahmoud Ahmadinejad, and Sudan President Omar Hassan Ahmad al-Bashir.

Coupled with the Bush Administration's decision to withdraw from the Kyoto Protocol for reducing global warming, the war in Iraq has significantly weakened global support and respect for the United States.

Admittedly, some of the resentment toward the United States stems from the fact that it is the world's sole superpower—militarily, economically, and culturally. This means whatever action it undertakes, militarily, economically, or politically has worldwide impact. So, too, American music, movies, television shows, and lifestyles that quickly spread around the globe, often overwhelming traditional national and regional cultures.

This may account for the fact that the Pew Surveys also show a rising antipathy toward the American people with majorities in such countries as Poland, Spain, Canada, China and Russia, who consider Americans as "greedy, violent, and rude." But at the same time Americans are viewed as "inventive and hard-working" in most countries surveyed.

The U.S. Public Diplomacy Program is Ineffective

The Bush Administration has sought to counter the wave of anti-Americanism with a $1 billion a year international broadcasting and communications program it calls "public diplomacy," run from the State Department by Karen Hughes.

The Defense Department directs its own information and psychological operations programs that have included paying journalists in Iraq to write favorable news articles.

Both programs have proved to be ineffective, according to former Defense Secretary Donald Rumsfeld, who said in a speech to the Army War College, "We probably deserve a D or a D-plus as a country as how well we're doing in the battle of ideas."

But most foreign policy experts believe that the global surge in anti-Americanism is less a public relations problem than a policy problem. At the core is what most now believe, that the decision to invade Iraq was a serious blunder.

The war in Iraq has weakened support for the global war on terrorism and the ongoing conflict there is draining America's military strength, straining its economy, and dividing the country politically. It is also providing a rallying ground for enemies of the United States like Iran's Ahmadinejad, Venezuela's Chavez, Sudan's al-Bashir, and North Korea's Kim Jong Il, not to mention Al Qaeda's Osama bin Laden.

Restoring America's Image

To begin restoring America's image worldwide, the biggest challenge facing President Bush and the new Democratically controlled Congress in 2007 is either to devise a program for extricating American forces from Iraq in an orderly and honorable manner, or to make a peaceful and convincing case on why America and its allies should be there.

The President and the Congress need also to put the Middle East peace process back on track. Without a peaceful settlement of the Israeli-Palestinian issue, the United States will not be able to make major improvement in U.S. relations with the Arab nations and Iran.

Finally, the President needs to create a more collegial relationship with other nations.

The likelihood of these transformations in 2007 is not high, so be prepared for a rocky road ahead in terms of the U.S. and the rest of the world.

IMPLICATIONS FOR BUSINESS:

- A continued upswing in anti-Americanism could have a negative impact on U.S. companies doing business abroad, not only in the Muslim world, but in Europe, Asia, and Latin America as well.

- The continuation of the current high levels of violence in Iraq and Afghanistan could generate accelerated terrorist attacks against U.S. interests worldwide.

- American multinational companies should review and possibly upgrade their security programs, particularly in nations where anti-Americanism is at high levels.

- An increase in terrorist threats against American interests might require higher wage scales for U.S. personnel working abroad.

THE ECONOMIC OUTLOOK FOR 2007: A SOFT LANDING, BUT SLOWER GROWTH

The resiliency and strength of the U.S. economy continues to amaze.

The U.S. weathered a stormy 2006 with:

- Record high oil prices;
- A severe downturn in the long robust housing market;
- Slipping consumer confidence;
- A decline in the dollar;
- An upsurge in violence in Iraq and Afghanistan;
- A perceived threat of inflation.

By year's end, oil prices had come down, inflation seemed tamed, consumer confidence was up, and the stock and bond markets were doing very well, indeed.

While the housing market continues to slump and the dollar shows signs of continuing decline, most economists expressed confidence that the long-running economic boom had made a soft landing and that 2007 would be a year of perhaps slower but solid economic growth, estimated in the range of 2.6 percent, compared with an estimated growth of 3.3 percent in 2006.

But despite the favorable outlook, there is ample reason for caution, because domestic and international events could change the global and U.S. economic climate negatively in a dramatic fashion.

- Tensions in the conflict-ridden Middle East could escalate and spread into a regional war, cutting off the flow of oil and driving energy prices once again to record levels (one expert predicted $300 a barrel).

- A drop in confidence in U.S. leadership could provoke a run on the already-declining dollar that could destabilize the global economy and spin it into worldwide recession.

- Pent-up protectionist sentiment in the U.S. and Europe could provoke ruinous trade wars and stall domestic and global economic growth.

But barring such developments, the economic prospects for the U.S. and the world in general appear positive for 2007. Much credit for the positive domestic economic outlook should go to new Fed Chairman Ben S. Bernanke.

Following in the footsteps of the legendary Alan Greenspan, Bernanke raised the benchmark interest rate by .25 percent on three consecutive meetings from March to June, to damp down growing inflationary pressures.

But then he held the rate at 5.25 percent despite pressure from inflation hawks who wanted him to raise it further and from many in the business and investment communities, who urged him to start reducing rates to stimulate a slowing U.S. economy.

Turns out Bernanke had it just about right. The consumer price index's core inflation rate for November, according to the Labor Department, came in at zero as falling fuel prices and discounts on cars, furniture, clothing, electronics, airfares, and hotel rooms offset hikes in wages and for many other goods and services. Although the November producer price index surged two percent—the highest increase since 1974—that was seen as an anomaly, fueled largely by the spike in gasoline, heating oil, and energy costs and did not reflect broader increases.

As a result, the year ended with manufacturing up slightly, unemployment low, real wages increasing, retail sales doing well, the stock and bond markets booming, and Wall Street's investment bankers drawing record high bonuses.

IMPLICATIONS FOR BUSINESS: Time for smart, long-term investments. Look at large-cap companies and for a record of steady growth.

ENERGY—THE NO. 1 PRIORITY

The all-you-can-eat energy buffet for the United States is over and a scenario for a perfect storm in energy supplies is developing.

The buffet is over because the caterers (the oil-producing countries) want more money for their vittles. It is over because more customers with voracious appetites (consuming countries like China) want a larger share of the buffet. It is over because some of the owners of the oil (Russia, Iran, and Venezuela) seek to disrupt the present system to the detriment of the United States.

Add the war on terror, the war in Iraq and the fact that the Middle East, the greatest depository of oil and gas on the planet, is in constant turmoil. All

the while our elected representatives are rudderless and have been for 40 years.
Our *Through the Looking Glass* world, where common sense is turned upside down, was apparent last summer when the largest American oil and gas discovery in a generation was announced—a find 175 miles off-shore in the Gulf of Mexico under 30,000 feet of water with a 3-to-15 billion barrel potential.

Every other nation in the world would have cheered if such a discovery had been made off its coast. Most of our politicians, pundits, and assorted glitterati treated the good news as though announcing a plague.

The massive discovery didn't even make page one in "the newspaper of record" and the article was larded with phrases that revealed a total misunderstanding of what is needed to get us out of our energy dilemma: "extraction extremely expensive"…"the discovery could make little more than a dent in the country's energy dependence"…and "the new areas at most hold supplies that would quench the nation's oil thirst for two years." Similar bleats were heard in Congress and on National Public Radio.

Some people just don't get the simple fact that every contribution toward energy supply, whether from conservation or fuel production, will be needed if we are to avert disaster. Even the President hasn't recognized this reality. He told the nation that we are "addicted to oil."

The U.S. is not addicted to oil. The U.S. is vitally dependent on energy, which is a different thing altogether. Energy supplies come in a variety of sources and it is, quite simply and reasonably, going to take the full panoply—fossil fuels, nuclear, bio-fuels, new technologies, renewables and conservation—to meet America's needs in the on-rushing future.

Energy and ingenuity have been at the core of our nation's prosperity. Energy is not the enemy but rather the life's blood of the nation. Ingenuity can play a major role in getting us out of this dilemma. This massive new discovery in the Gulf of Mexico is based on technology that was almost unthinkable not many years ago. This is American ingenuity at work, but with every tick of the clock the chances of our escaping our own folly become slimmer. Not every nation in the world is as cavalier with its future.

China leads the pack of realists. It is securing oil supplies from the South China Sea to the Middle East and is now exploring less than 100 miles off the American coast in Cuban waters. Nuclear plants are being built at a rapid pace. The Chinese have done some work on renewables, but are now the world's top air polluter. China is serious about its future.

Russia, with major fossil fuel reserves, is the most interesting player of all. It is using these reserves as diplomatic and economic tools; some have even suggested weapons. Gazprom, Russia's natural-gas export monopoly, now provides Europe with about 25 percent of its natural gas. In Asian Russia, Gazprom even bludgeoned Royal Dutch Shell, Mitsubishi and Mitsui into surrendering control of the Sakhalin-2 oil and gas project, which is the world's largest energy development. Incidentally, have you noticed red and white Luk Oil signs at some of your local gas stations? That's a chain of Russian-owned retail gas stations.

In the U.S., leaders of all political persuasions have given us more than 40 years of energy policy negligence. Each side of the aisle has pandered to its own special interests. This mismanagement now threatens the prosperity and safety of the nation. Lack of adequate energy will prevent us from flying, driving, cooling, heating, feeding, and defending ourselves. Our money will be devalued as central banks shift their reserves out of dollars into euros, Asian currencies, inflation etc. and so on into chaos. Meanwhile, the Democrats, who now control Congress, plan to eliminate subsidiaries for oil companies, because they are enjoying record profits.

Based on past performance, the U.S. cannot expect much leadership from government. However, informed outside pressure seems to be building. The Council On Foreign Relations recently released a blue-ribbon independent task force report declaring that it had reached "a sobering, but inescapable, judgment: the lack of sustained attention to energy issues is undercutting U.S. foreign policy and national security."

America needs to develop and support a road map to "Energy Sufficiency" not "Energy Independence", which is a dangerous chimera that is neither desirable nor possible. The road map would recognize the need for maximization of every form of conservation and efficiency as well as the utilization of every available fuel source. It would force us to face energy reality for the first time in two generations.

<u>IMPLICATIONS FOR BUSINESS:</u> The nation's economy runs on energy—meaning the energy issue must become the high-priority concern of every American businessman and woman. If we can remember that there is no "magic bullet" and that "all contributions are gratefully accepted," we may avoid the disaster our politicians and our ignorance has led us into. But timing is everything and everything in the energy business takes time, a lot of time. Do we have the time?

On the investment front, according to analyst Joel Kurtzman, a senior fellow at the Milken Institute, "if the past is any predictor of the future, we will continue to see declines in oil and gasoline prices most likely continuing over the next twelve months. Falling oil prices may be good news if you drive an S.U.V., but for anyone investing in alternative energy, it's déjà vu all over again."

"The reason oil prices are likely to fall is that oil is the new gold. When global tensions rise, investors flock to oil. They do it through mutual funds, hedge funds and futures contracts. Too much (some would say dumb) money chasing plenty of oil is sending prices soaring. But when tensions subside, big investors become scarce and oil prices drop. Doom-and-gloom may repeal the laws of supply and demand for a while, but sooner or later reality sets in. When it does, people will see there is plenty of oil for a long time to come."

TERRORISM: A TRUE THREAT THAT MUST BE RECOGNIZED

Interviews with key figures at five intelligence agencies reflect that terrorism continues to be very much with us, is growing, and will not abate any time soon.

The good news is that, while terrorists have tried to link together in a strong global movement, they have so far failed. Al Qaeda has shifted from a highly-centralized operational model to a broader global jihadist movement. The new model encourages independent "grass roots" jihadists to conduct localized attacks. This change has given Al Qaeda wider geographic and operational reach, but lacks the skills of the core group and its expert terrorist cadre. This shift also saw the number of attacks and casualties go down in 2006, directed at softer targets such as tourist hotels, trains, and the like as well as at energy facilities.

The bad news is that terrorists continue to try and that we will need to think about and address this issue for the rest of our lives.

Some disturbing developments:

- Last Fall, the Pakistani government signed a "truce" with terrorists that permits them to stay in the region as long as they promise to halt attacks;

- In Afghanistan, NATO forces have been surprised by the size, and now strength, of the Taliban insurgency;

- Roadside bombings in Afghanistan have doubled this year, and suicide bombings have tripled;

- The CIA has disbanded Alec Station, the unit assigned to hunt down bin Laden and his lieutenants;

- There are now many radical splinter groups throughout the Middle East that take the same form as Al Qaeda: Messianic leaders inspiring young men to give up their lives in the name of a more authentic faith.

- Al Qaeda is openly offering military training in Uzbekistan, Kyrgyzstan, and Turkmenistan;

- Terrorist attacks are occurring around the world with such frequency that they are not even being reported globally.

Dozens of new terrorist gangs are starting, made up of young men between 15 and 30 who are radicalized and against the West. 70% come to these groups through friends, 20% through kin, and 10% through the Islamic schools or madrassas located in Indonesia and Pakistan. Eight percent are Christian converts to Islam. The average age of those arrested in the past two years, who are allegedly affiliated with Al Qaeda, is 22, compared with 26 a few years earlier.

Those who follow terrorism suggest that leaders are positing a three-part strategy:

1. Bring more recruits to the cause;

2. Polarize the Muslim world against the West. Tactics used by fundamentalists in this effort can be devastating and range from brutal bullying of locals to ridiculing Hollywood films that reflect values not in line with those of the terrorists;

3. Drive the U.S. and Britain from the Middle East, leaving the jihadists to operate freely and take over governments. Part of this tactic is to make it so expensive to fight terrorists that matters that should be attacked in the West are left alone.

<u>IMPLICATIONS FOR BUSINESS</u>: If you plan to do business in the Middle East, starting with Morocco and moving toward Iran, be extremely careful and vigilant. If you intend to do business in Central Asia or in countries like Uzbekistan, Turkmenistan, and Indonesia—be doubly careful.

THE SHAPE OF THE WORLD

Huge population changes are taking place. Between now and 2030, India will boast a population of 1.53 billion and overtake China as the world's most populated country. In 2030, China will have 1.46 billion people. By 2030, China's population will also be aging and is likely to be in decline.

Between 2030 and 2050, India will add nearly 300 million to its population. China will lose about 40 million people. Each country faces a demographic crisis: China's population of aging citizens is rapidly outgrowing the workforce that will be needed to support it; India has a huge population of young people—54% under 25 and 70% below 30. The poverty and potential unrest in both countries is incredible.

The United States—the third largest country in the world—will grow steadily between now and 2050 thanks to immigration, which remains a political hot potato. In 2050, the U.S. population will stand at some 420 million, up from 300 million today. Meanwhile, most of Europe is experiencing a population implosion, reaching historic lows.

Other population trends between now and 2030:

- Brazil, which currently ranks fifth in population directly behind Indonesia, will fall to seventh in 2030, being displaced by Pakistan and Nigeria;

- Russia is being ravaged by alcoholism, cardiovascular disease, AIDS, and other diseases and will decline to 124 million in 2030 from the current 142 million, dropping the country from 8th place to 11th in terms of global population. Russia's population growth will remain far below replacement rate—the country is projected to drop to 15th place by 2050 with a population of just 109 million;

- Japan's population will drop from 127 million to 116 million in 2030, thanks to one of the world's lowest birth rates;

- The average population growth of a group of seven of the largest Muslim nations between now and 2030 will be 27%. Included in this group are: India, Indonesia (231 million vs. 288 million), Pakistan (165 million vs. 244 million), Bangladesh (147 million vs. 219 million), Egypt (79 million vs. 109 million), Turkey (70 million vs. 84 million), and Iran (65 million vs. 80 million);

- Average population growth among the five largest countries in Western Europe will average zero. Included in this group are Germany (82 million vs. 79 million), France (60 million vs. 63 million), the United Kingdom (60 million vs. 64 million), Italy (58 million vs. 55 million), and Spain (40 million vs. 39 million). If current birthrate trends continue, Europe will have a shortfall of 20 million workers by 2030.

<u>IMPLICATIONS FOR BUSINESS:</u> Better understand the culture of these Muslim nations because they are not going to adapt to the West. Find locals who can carry your business. Watch for signs of unrest. Bridges need to be built to the Muslim world. Markets to sell will take a different shape and require new approaches and techniques respectful of local culture and history.

THE CHANGING FACE OF AMERICA

<u>More People:</u>

The United States remains the only Western industrialized nation to continue to register significant population growth. U.S. population hit the 100 million mark in 1915; doubled to 200 million by 1967; and hit 300 million in late August, 2006.

America's diversity has reached nearly every state as minority groups make up an increasing share of the population everywhere but West Virginia.

More American immigrants, legal or not, come from Mexico than from any other country. In 2005, an estimated 11 million of our foreign-born came from Mexico, compared with 1.8 million Chinese and 1.4 million Indians.

<u>Non-Hispanic Caucasians Decline as a Percentage of U.S. Population:</u>

The share of the U.S. population that is Caucasian, but not Hispanic, is declining as minority groups grow rapidly. The percentage of non-Hispanic Caucasians dropped below 50% in four states—California, Hawaii, New Mexico, and Texas—and the District of Columbia. Non-Hispanic Caucasians are still a majority nationwide at 66.8%, down from 69.1% in 2000 and 75.6% in 1990.

The number of immigrants living in American households rose 16% over the last five years. And, increasingly, immigrants are by-passing the traditional gateway states of California, New York, Texas, Florida, and New Jersey, and are settling directly in regions like the Upper Midwest, New England, the Rocky Mountain states and the Southeastern states of Georgia and North Carolina.

The number of undocumented individuals has jumped from 3.5 million in 1990 to more than 12 million today, with Mexicans, far and away, in the majority.

Other important data:

- The average educational level of Americans is increasing. The number of Americans over 25, who hold a bachelor's degree or higher, rose from 24.4% in 2000 to 27.2% in 2005;

- While the overall population is increasing, the percentage of Americans 65 or over is shrinking, from 12.4% in 2000 to 12.1% in 2005. This is due to the huge influx of young immigrants;

- But the percentage of Americans 65 and older will increase within five years thanks to the enormous "baby boomer" generation, the first group of which turned 60 this year, and will start reaching 65 beginning in 2011.

- With an average 80 people per square mile, as compared to 2,594 in Bangladesh, 876 in Japan, or 635 in the U.K., the U.S. does not have a population problem as such. It is a problem of population distribution.

Suburbia Is Also Diversifying/Clusters Developing:

American suburban counties are becoming increasingly multi-ethnic, while Caucasian populations are growing slightly in some urban areas, and most suburban communities continue to record robust population growth from Hispanics, African-Americans, and Asians.

For example, from 2000 to 2005, the Hispanic population in Maricopa County, Arizona increased by 280,449; in Harris County, Texas, the increase was 252,967; and in Riverside County, California, the increase was 228,331.

From 2000 to 2005, the African-American population in Broward County, Florida increased by 79,856; in Gwinnett County, Georgia by 57,135; and in Prince George's County, Maryland by 44,730.

During the same five-year period, the number of Asians in Orange County, California, increased by 74,493; in Santa Clara County, by 69,691; and in Queens County, New York, by 42,927.

The Migration to Florida and the Southwest Continues:

Nine cities in Florida and the Southwest are registering the fastest percentage population growth in the U.S.

They include, from 1-to-9: Elk Grove, California; North Las Vegas, Nevada; Port St. Lucie, Florida; Gilbert, Arizona; Moreno Valley, California; Rancho Cucamonga, California; Miramar, Florida; Chandler, Florida; and Irvine, California.

In sheer numerical growth, the five fastest growing cities in America, all in the Southwest, are, in order: Phoenix, San Antonio, Fort Worth, North Las Vegas, and Gilbert, Arizona.

The Trend Toward Isolation:

There is a surprising trend toward isolated dwelling in America.

Fully one-fourth of the nation's households—27.2 million—consist of just one person. This compares with only one in 10 single-person U.S. households in 1950.

But, ironically, the nation is more connected than ever before—by telephone, e-mail, instant messaging, and pagers.

At virtually every level, fewer Americans are marrying, but the decline is most pronounced among men with less education. About 18% between the ages of 40 and 44 with less than four years of college have never been married, up from six percent 25 years ago.

Today, there are more than five million co-habitation households with unmarried partners of the opposite sex, compared to only 1.6 million in 1980.

More than 70% of women ages 25 to 54 are working today, almost double the percentage of women working 30 years ago.

Wages for working women have increased more rapidly than have men's. Between 1979 and 2003, the earnings of men with a few years of college, but no degree, barely kept pace with inflation while wages for women rose 20% in real terms.

A study in the *American Sociological Review* finds the average American had only two close friends in whom they would confide on important matters, down from an average of three confidants in 1985. The number of people who said they had no such confidant jumped from 10% in 1985 to 25% in 2004. An additional 19% said they had only one confidant, often their spouse.

<u>IMPLICATIONS FOR BUSINESS</u>: Voting patterns, consumer buying habits, pressure from interest groups, and much more are being re-aligned in the U.S. Any company not watching this closely and adjusting its outreach strategies accordingly, will get left at the starting gate.

AMERICA'S MILITARY: WHAT'S NEXT?

America's armed forces are stretched to the breaking point. Only a third of Army combat units are fit for deployment. There is an urgent need to re-supply the Army and Marine Corps after the heavy drain on equipment in Iraq and Afghanistan. Tanks, helicopters, Humvees, body armor, ammunition—the list goes on and on. The war is using up $2 billion a month in these necessities.

But there is a far larger question: What kind of military is the U.S. going to have in the future?

America spent nearly half a trillion dollars last year on the military, more than all the other nations of the world combined. Most of the money, however, goes for expensive high-tech weapons, many of them holdovers from the Cold War—B-1 bombers, B-2 bombers, nuclear submarines, etc.

The defense industry and its allies in the Pentagon keep pushing expensive new weapons at Congress, like the F-22 fighter. There simply isn't enough money to do everything that the nation would like to do. Some tough choices must be made.

Is the U.S. going to invest in more troops, or is it going to keep buying weapons systems? The answer is neither obvious nor easy. Spending more on troops may seem simple, but the estimated annual cost of a single service person is $100,000, so any major troop buildup will be enormously expensive. Generals cite the need to expand the Army, but it's tough to get young people to join.

There are hundreds of cities and towns across the nation whose economies rely heavily on local defense contractors. Indeed, the defense industry has structured itself so that there is widespread political support for its continued funding.

Look for a vigorous debate on this topic and for some support for Representative Charles Rangel's call to restore the draft.

__IMPLICATIONS FOR BUSINESS:__ While continued huge dollar outlays for defense assures prosperity for military contractors and jobs for workers in those industries, it takes its toll on many other sectors of the economy and other government-financed activities, not to mention an ever-exploding astronomic national debt and the burden that is being shifted to future generations. Federal budgeting is a zero-sum game and choices have to be made. High stakes on the table for companies and for the nation, which is coming under more pressure around the world every day. Negative reaction from young people is also a real possibility.

THE U.S.—THE ONLY SUPERPOWER?

Everyone knows that the U.S. is the world's sole superpower, at least as measured by military might. Everyone also knows that attitudes toward the U.S. are not positive and that the drain on the U.S. military position is considerable.

Beijing, Delhi, Riyadh, London, Berlin, and Moscow are all starting to exhibit levels of power not seen before. And it is economic, not military, power.

Look for China to be active politically and economically up to, and accelerating after, the 2008 Olympics; expect India to deepen its efforts to pass China; watch for the oil card to be played by the Saudis, who are under enormous pressure from terrorists. The jury is out on what will happen after Tony Blair's departure, but the British will not be quiet; nor will the Germans, who are just starting to step on the gas economically. And then there is Russia and Vladimir Putin, a man who is expected to step down in 2008, but someone who will not walk away from power.

__IMPLICATIONS FOR BUSINESS__: New power positions in the world are starting to take shape and the U.S. should not rest easy. The debate on globalization will heat up and the result will be defined not by the U.S. or its businesses, but by how the parochial and nationalistic pride of nations where the U.S. does business reacts to America. All types of incentives will be offered to businesses and some will "sell out" and damage the position of the U.S. in the world.

HOW WE RATE

A recent study compares the U.S. with other nations that belong to the Organization for Economic Cooperation, and shows the U.S. is:

No. 1	in military standing;
No. 2	in income per capita. (oil-rich Norway is No. 1);
No. 5	in productivity (in 2004);
No. 5	in unemployment rate;
No. 1	in number of weeks worked each year;
No. 1	in healthcare expenditures per capita;
No. 16	in life expectancy;
No. 16	in number of people living at, or below, the poverty line.

<u>IMPLICATIONS FOR BUSINESS:</u> In the wake of other economies "wanting theirs," there will be enormous political, social, and economic pressure on U.S. business to hold its leading positions and improve on those that are less positive. This will require a new way of thinking in the executive suite and on the part of private equity that is now playing such a big role in the broader economy and, of course, by hedge funds, too.

VANISHING U.S. MANUFACTURING

It's not exactly a secret that the U.S. has been losing manufacturing jobs over the past few decades at an alarming rate. despite a huge surge in population. Currently, the total number of U.S. workers employed in factories is down to only 12 million. That's a loss of 2.3 million since 2004 alone when the figure stood at 14.3 million. Earlier, between 2000 and 2004, we lost more than three million jobs. A relative high point for the post-war period was reached in 1978 when the U.S. had 19 million Americans employed in manufacturing.

Economists may argue about the principal reasons for this steep decline, but outsourcing—especially to countries like China—has surely been a major factor. The decline also is tied directly to the nation's ever-mounting global trade deficit, which will probably top $800 billion—a new record—when the final numbers are in for 2006—the lion's share, by far, from Chinese imports. Americans' appetite for foreign-made products appears to be insatiable. That compares with a foreign trade deficit of only $1.3 billion in 1950!

Once the world's leading manufacturing hub, the U.S. is, today, a service-driven economy and an exporter of raw materials, not unlike most Third World nations. In the first decade of the 21st century, China reigns as "the factory of the world." And waiting on the sidelines are countries such as India, Vietnam, Cambodia, and Sri Lanka, not to mention much of sub-Sahara Africa, all with countless millions eager to work for a pittance compared to American wages.

Meanwhile, national security strategists caution that relying on the rest of the world for too many essential manufactured goods could expose the U.S. to dangerous vulnerability in the event of some major international geo-political/military crisis or upheaval. We do not enjoy, today, the infrastructure that put the United States in a positive position during World War II.

IMPLICATIONS FOR BUSINESS: Don't look for these jobs to return anytime soon. The incoming Democratic Congress, with the strong backing of labor, will probably sponsor legislation to create a more equitable balance between unfettered free trade and protectionism—what is often labeled "fair trade." Eliminating certain tax benefits for companies that are big outsourcers, while providing meaningful tax incentives for those that continue to manufacture here, is also on the docket. But stemming the tide of vanishing manufacturing, and its attendant negative impact on innovation, high productivity growth, and buoyant economic performance, will not be easy.

HEDGE FUNDS: ARE THEY CREATING "SYSTEMIC RISK?"

Are hedge funds–now, at least 3,000 in the U.S.–making global financial markets more risky?

Hedge funds control a staggering amount of global assets—$1.3 trillion as of year-end 2006, up 21% from 2005. Through their use of leverage, they amass trading positions in many multiples of that amount.

To answer the question of whether hedge fund managers are creating "systemic risk" in the world's financial markets, it's helpful to think in terms used by asset managers and other institutional investors.

These professionals divide market returns into two categories: Alpha and Beta. Beta is investment return generated entirely by market movements. When your S&P 500 Index Fund returns 14% for the year, as it had through the waning days of 2006, that's pure Beta. Alpha is investment return generated through the skill or strategies of investors above and apart from market returns.

Many hedge funds are advertised as "Alpha generators." In other words, the reason investors are willing to pay two percent of assets and 20% of profits in fees is that they are convinced their hedge fund managers are good enough to generate far more than that amount in Alpha.

But with the flood of money into the hedge fund industry and the corresponding launch of hundreds of new funds, managers are finding it much more difficult to develop ways to consistently produce Alpha. Returns for all hedge funds averaged 10.65% in 2006, up only slightly from 8.98 percent in 2005.

As the market becomes more competitive, many investors have begun to question whether hedge fund managers—especially newcomers to the market and others without proven track records—are producing real Alpha, or if their proprietary strategies actually boil down to leveraging Beta—or market returns—with borrowed funds. Such an approach obviously increases returns when markets are in positive territory, but it also magnifies losses when markets are falling.

This speculation raises the essential question: Are hedge fund investments in aggregate correlated to other global markets? Critics warning of systemic risk say they are. Unfortunately, because hedge funds and their strategies are cloaked in so much secrecy, such questions will be answered the hard way in the next major downturn.

Hedge fund managers eventually might be subjected to new regulations that could, in theory, make some of this information available. Members of the incoming Democratic Congressional majority, as well as some Republicans, have indicated that hedge fund regulation is on their agenda, and regulators in Europe have said the same in more forceful terms. However, last year's aborted attempt by the Securities and Exchange Commission to force hedge funds to register with that body reveals the complexity and difficulty of the undertaking. Based on this experience, it appears unlikely that a new regulatory regime will take effect in any major market within the next 12 months.

<u>IMPLICATIONS FOR BUSINESS</u>: In the absence of any major regulatory changes, hedge funds will continue to proliferate. Institutional investors around the world say they still have plans to increase their hedge fund investments significantly.

As new funds open and existing funds grow, however, the sheer size of their presence is raising new red flags in certain markets critical to global commerce, namely currencies. There are genuine fears about systemic risk to the larger financial system because of their size and number. Some critics contend that the aggressive trading strategies of hedge funds—which are trading FX (foreign exchange) not to hedge other positions, but to make money—are by themselves increasing volatility in global currency markets.

In addition, because hedge funds now account for a substantial and growing percent of trading volume or "liquidity" in several markets, it is an open question as to how a sudden downturn in hedge fund performance will affect global trading.

Hedge funds are now generating large portions of daily trading volume in markets such as high yield bonds, emerging market bonds, credit derivatives and—increasingly—FX.

In the next market reversal—and it surely will come—hedge funds may be forced to sell large currency holdings to cover margin calls related to losses in these other markets. If so, their presence could be the tipping point that propels a financial event into a much broader economic crisis.

Businesses (and especially Boards) investing with hedge funds must be especially cautious going forward and meticulously check the track record of those they entrust with shareholder money.

PRIVATE EQUITY: THE NEW PROFIT MODEL

Private equity (PE) smashed all records for the sector in 2006. The value of announced deals rocketed to $700 billion in 2006, more than twice the record set in 2005, and 20 times more than 1996, according to Thomson Financial. It's easy to see why PE is so popular, despite a fee structure (the infamous "2 and 20," or two percent of capital plus 20% of profits) that would seem to gag the ordinary endowment or pension fund manager. In a word, it's returns.

For 15 years or so, private equity returns have walloped those in the public markets. Indeed, the one-year average buyout return was 27.3% as of June 30, 2006, according to Thomson. The deals are routinely bigger than ever these days. Eight of the 10 largest buyouts ever were announced in 2006. These included household names such as Albertson's, Harrah's Entertainment, Clear Channel Communications, and healthcare giant HCA. Even the possibility of a $100 billion buyout no longer seems absurd.

In short, private equity is fundamentally altering the way business is done, both here and abroad. The changes may be most pronounced in the U.S. and Western Europe, but they are also insinuating themselves into the daily fabric of business life in Eastern Europe and Latin America.

Where is all this "going-private" activity headed? Great question, difficult answer. Considering the rush of new and less sophisticated money into the private channel (institutions and individuals), plus the likelihood of lower returns from newer PE shops, a market top would seem in the offing. There are deep rumblings of increased regulatory oversight, though what form that might take is far from clear. The U.S. Justice Department is looking into "club deals" (in which a group of the biggest PE funds agree to make a collective bid on a target company) for evidence of price-fixing and collusion, but many outside observers see that investigation going nowhere.

Nationalism is also rearing its head again in Europe, where investors and politicians are voicing concerns (or in some cases, rejecting bids outright) over the huge premiums being lifted out of public companies there by foreign PE firms. What is more, the embedded inequality of the PE model–slash labor costs, abolish unions, make workers pay for more of their benefits such as healthcare, all while PE executives get rich beyond comprehension–is also drawing attention and criticism. One of PE's biggest stars, Blackstone's Stephen Schwarzman, has publicly cautioned about the growing disparity of income in the U.S.—and its potential political repercussions.

IMPLICATIONS FOR BUSINESS:

- We see no disaster for private equity, but an easing back in activity. If overall returns begin to swoon, investors will naturally cut back on their PE allocations, and many of the newer, less competent PE shops will have to close, returning unused funds to their investors. Of course, unforeseen events such as a radical turn in the credit cycle, or a blowup in credit derivatives, could dramatically affect the ability of PE shops to finance purchases.

- Another possibility: The private model is so much more efficient than the public one that it becomes the preferred investment vehicle for big investors for many years to come. The public model is now simply so bloated with Sarbanes-Oxley costs and strictures that it risks becoming a permanent also-ran. If so, public company employment would then have no more cachet than government employment today.

- The battle for talent is being won, hands-down, by alternative investment vehicles such as hedge funds and private equity funds. The best investment bankers and top operating managers from industries up and down the spectrum are already flocking to private equity shops in droves. The lures: Profit participation schemes that can dwarf what they earn at their current employer, plus the chance to be part of an entrepreneurial environment. Certainly, if public companies want to retain their top talent, they will need to continue making adjustments to compensation packages.

- Now may be the time for divestitures. If all the regulatory or end-of-cycle chatter worries you, and you have been toying with the idea of a sale or divestiture, you may want to pull the trigger on that plan in the very near future. A sale now would bring top dollar. Both the M&A and private equity markets may be at cyclical highs, and ordinary deals could be harder to get done in the future.

- Joint ventures might also be worth a look. Traditionally, publicly traded companies have been hesitant to enter into joint ventures or other forms of partnership with private equity firms. If the current environment persists for any period of time, however, companies may want to consider private equity joint ventures as vehicles for unloading underperforming or non-core assets. Such an arrangement can offer several benefits, among them the willingness of a PE partner to undertake the radical restructuring steps that would be difficult for a public company. After a restructuring, the public partner can then participate in improved performance and enhanced value.

DEVOLUTION OF GLOBAL FINANCIAL MARKETS

In financial markets, capital is moving away from large, well-regulated bureaucratic, and highly regulated organizations to smaller, aggressive, entrepreneurial, and thinly regulated organizations (hedge funds, private equity managers). Risk is being decentralized in a similar manner as credit derivatives and other instruments allow smart people to slice risk and sell it off in finely parsed portions to institutions and individuals of all kinds, all over the world. The upshot is a decentralization or devolution of global financial markets. In many ways, we are looking at the "new" conglomerates where risk in large private equity companies is being laid off against its parts.

In other words, bigger is better.

A concrete example: Some large investment banks are claiming that the global "contagion" witnessed in the 1990's emerging markets crises is no longer likely due to the increased sophistication of risk management through derivatives. In short, they think that there is less connection between the economies of different emerging markets countries, and they are using this argument to encourage investors to take bigger positions in emerging markets.

<u>IMPLICATIONS FOR BUSINESS</u>: We are in uncharted territory. Does the movement of capital and risk from the center to the periphery increase risk due to lack of regulation or transparency or decrease it by spreading risk across a broader base? What happens if the big players are wrong? One thing is sure: Many are getting very wealthy and doing very little for it.

CUBA AFTER CASTRO

Fidel Castro's domination of Cuba and that country's position and influence in the Western Hemisphere may be over.

The question is: What's next?

Castro's brother, Raul, will continue his leadership for the time being. Speculation abounds, but one may be sure that the Cuban Communist Party and the military and intelligence system will stay in place for the timing being, at least.

Despite this internal continuity, Castro's goal—to revolutionize Latin America and the Third World, confront American imperialism, and exploit the gap between the haves and have nots—is now open to serious pushback.

Raul Castro is no Fidel and, without a dynamic leader, Cuba will change.

Cuba is now largely in the hands of functionaries, who cannot pursue the goals Fidel Castro embraced. Without those goals and charismatic leadership, expect the regime in Cuba to crumble in perhaps the not-too-distant future.

Fidel Castro promised major economic improvements. It didn't happen. When he fell ill, he was already calling for economic relations with the West.

Cuba, situated 90 miles off the coast of the U.S., is important to this country. When ships from New Orleans exit the Gulf of Mexico, they must cruise two narrow channels on either side of Cuba—the Yucatán channel, which lies between Cuba's western coast and Mexico's Yucatán peninsula, and the Straits of Florida, which lie between the island's northern coast and Florida. If these two channels were closed, U.S. shipping would be severely damaged.

Cuba cannot today close those channels. But another power could and that would pose a serious economic threat to the United States. Add to that the possibility that missiles could be fired from Cuba to the United States.

It is not Cuba itself that is a threat, but rather a Cuba that is allied with or dominated by a foreign power challenging the U.S. globally, a fact brought home in frightening detail during the Cuban missile standoff between the U.S. and USSR in 1962.

We know for a fact that Cuba has reached out for help to China, Russia, North Korea, and others, but there has been no new link established. Meanwhile, Hugo Chavez of Venezuela and Evo Morales of Bolivia, both of whom want to claim their place as the leader of the Latin American left, see opportunity.

Expect a struggle. But Washington is not unaware of the possibilities for future change in Cuba nor will the thousands of Cuban exiles in the U.S. be silent. In a short time, look for Cubans to seek and define themselves by their relationship to this country. If this does not happen, all bets are off and the U.S. will have a very unpleasant situation to address.

<u>IMPLICATIONS FOR BUSINESS:</u> There could be huge opportunities in everything from tourism to exports/imports in a post-Fidel Castro Cuba, and Cuba may emerge as a leader in the Caribbean. Trade can flourish, along with business interests. Look for South Florida to boom if a viable future commercial link can be established with Cuba. This is one Washington has to get right.

LATIN AMERICA: A CHANGING LANDSCAPE THAT HAS POTENTIAL—WATCH HUGO CHAVEZ

Latin America has the world's most unequal distribution of wealth outside of sub-Sahara Africa. Its richest 10% earn 48% of total income, while the poorest earn just 1.6 percent. Indeed, one in four Latin Americans live on less than $2 a day.

The hardship of the region has created both positive and negative potential of some proportion.

The few on the extreme left, like Chavez in Venezuela and Morales in Bolivia, simply reject all U.S. policies, especially those emanating from the current Administration. Specifically, the economics of oil has emboldened Hugo Chavez to repeatedly challenge the U.S. It was, in fact, Chavez's 1998 landslide victory in Venezuela that began what many in the United States call the downward (leftward) spiral. It is impossible to predict whether a new president with a fresh, more open approach to Latin America would mitigate such anti-Americanism, but it is a distinct possibility.

Meanwhile, Chavez is extending his influence far beyond the borders of Venezuela as presidential candidates he has supported elsewhere in Latin America during the past six years have won—or came close to winning—elections:

- Chavez-supported Morales won the presidency of Bolivia.

- In Peru, center-left socialist Alan Garcia defeated Ollanta Humala, a nationalist former military officer supported by both Chavez and Morales.

- Michelle Bachelet, a single mother and socialist, gained a third term for Chile's center-left Concertación Coalition.
- President Luiz Inacio Lula da Silva, also a moderate leftist, was re-elected in Brazil, extending his term to 2010.

- Sandinistas have made a comeback in Nicaragua with the election of former leader, Daniel Ortega. During the campaign, Ortega took on the language of the center-right, espousing capitalist reforms, and pushed for conservative values, especially a ban on abortion—a move strongly endorsed by influential Catholic Church leaders. But observers fear that once in office he may return to his Sandinista roots.

- Ecuadorians elected economist and the nation's former finance minister, Rafael Correa, also a populist man of the left, but a moderate.

In Mexico, the center-right candidate, Felipe Calderon, beat out Chavez's favorite, Manuel Obrador, for the presidency. But Calderon indicates that he, too, will introduce social reforms, which in some circles could suggest that Chavez's influence extends even to the opposition.

There is little doubt that American influence throughout the region is at a low ebb. Emotional rhetoric in the U.S. on topics like immigration reform also put more distance between America and most countries to the south.

<u>IMPLICATIONS FOR BUSINESS:</u> Recognize that strong populist leaders have, and will, emerge in Latin America to rally their citizenry by pitting those who have nothing against those who seem to have it all. Latin Americans are likely to continue exclaiming "basta," demanding a much bigger slice of the wealth their nations produce.

Latin Americans are an able and resilient people, who have been through the hardest of times. Little can shock them. Also, look for leading Latin American families to play an important, but behind the scenes, role in working to bring stability to the region.

Those wanting to do business in Latin America should seek to understand the history and culture of the markets and recognize that many of the new breed of left-leaning Latin American leaders are realists and pragmatists who will invite investment and economic cooperation. Important leaders such as Lula in Brazil, Bachelet in Chile, Garcia in Peru, and Kirchner in Argentina are not reflexively anti-American. They are social democrats who acknowledge constitutional limits and encourage global capital flows, international trade and investment, and economic stability.

Even in Venezuela, however, actual events on the ground often belie Chavez's fiery anti-American rhetoric. Although substantial oil money has been distributed to the nation's poor, Venezuela remains, essentially, business-friendly. There has been only minimal land reform, virtually no additional nationalization of industry, little interference with markets, and business between the two countries continues to be robust. We are Venezuela's largest customer—primarily, oil—and the U.S. is the No. 1 exporter of goods to Venezuela. In fact, trade between both nations increased some 36% in the year just past.

IRAN—A POWER KEY

Anything can happen in this nation and whatever does occur will change and challenge the world for the foreseeable future.

Iran has the world's second-largest proven reserves of oil and natural gas, but its refining capacity lags far behind its needs. Rather than spend petro dollars, Iran has stockpiled billions into an "Oil Stabilization Fund." No one knows how these monies will be used. Moreover, Iran is not at all transparent in its nuclear efforts.

35% of the nation's population is young—between 15 and 30; and this group is saddled by unemployment, widespread drug use, a crumbling infrastructure, and a public bureaucracy that does not work. The economy remains controlled by the all-powerful mullahs, who neither pay taxes nor have accountability.

According to intelligence sources, people are tired and want change. President Ahmedinejad combines anti-Western rhetoric and anti-Semitism as he pushes for nuclear capability. But recent anti-Ahmedinejad student demonstrations in Tehran suggest opposition is mounting. Meanwhile, the impact of sanctions just imposed by the U.N. is still unclear. Ahmedinejad has vowed that they will not prevent Iran from proceeding with its nuclear program.

In our last Report, we wrote about Iran's Revolutionary Guard Corps (IRGC) that controls Scud missiles and chemical and biological weapons arsenals. Iran also has 5,000 men in its Qods Force, a group that works in foreign countries. This is a dangerous unit.

The pieces are in place for a major problem. Ahmedinejad and his followers seem eager for the confrontation that is looming. How this will be handled depends on diplomacy from the U.S. and the U.K.

<u>IMPLICATIONS FOR BUSINESS</u>: Watch this country carefully. A serious confrontation with the U.S. will result in huge regional instability and a military solution, though unlikely, can never be ruled out. A positive solution could, however, alter the future in very constructive ways.

RUSSIA: THE BEAR’S GROWL GROWS LOUDER

Two disturbing trends must concern any business executive thinking of doing business in Russia: endemic government corruption and an apparent drift toward repressive Soviet-era policies. Russia, today, defies easy characterization.

The OECD puts it this way: “Instead of moving to improve the abysmal quality of public administration, Moscow has focused on expanding state ownership of strategic business sectors, further increasing the corruption and lack of transparency. In October, Russia was rated on a par with Rwanda and Swaziland on the International Corruption Perception Index.”

Far more troubling is the widespread belief that the government of President Vladimir Putin is assassinating its most vocal critics. Two recent cases made world headlines: the brazen shooting of journalist Anna Politkovskaya and the radiation poisoning of ex-KGB agent Alexander Litvinenko. No one has traced these and other murders directly to the Kremlin, but suspicions abound. And there is no question Putin has arrested scores of political opponents; shut down TV stations and newspapers that were critical of him; and turned the parliament into a virtual rubber stamp. Politically, Putin seems determined to restore the stature and power enjoyed by the former Soviet Union. He has even called the demise of the old Soviet empire “the greatest geo-political catastrophe of the century.”

Oil and natural gas are prime targets of the nationalization drive. In December, Gazprom, one of the two state-owned energy giants, forced Royal Dutch Shell to cede control of its $22 billion project in the Sakhalin energy field. Shell gave in after being hit with environmental violations in what many saw as thinly disguised arm-twisting. British Petroleum has been the target of similar tactics over its gas field in Siberia. Such actions would be troubling under any circumstances. They are even more alarming, given the scope of Russia’s energy resources–seventh in the world in oil reserves, second in oil production, first in natural gas reserves–and Putin’s apparent willingness to use energy as a foreign policy weapon. When Russia threatened Belarus with a cutoff of its gas supply if it didn’t agree to a huge price hike, doubling its current price, that former Soviet republic capitulated on December 31, and even had to agree to sell Gazprom a 50% interest in its own gas pipeline network. Similar terms were also extracted from neighboring Ukraine and Georgia.

Putin’s second term as president expires in May 2008, and the Russian constitution forbids his running again. He has said he will abide by that. But questions persist about whether he means it and, if he does, whom he might designate as his successor. Given his 70% approval rating, there seems little doubt Putin could name his man.

Russia's muscle-flexing has exacerbated tensions with the U.S. The cooling relationship was evident at the G8 Summit Putin hosted in St. Petersburg in July. Presidents Bush and Putin, who once seemed to enjoy a warm relationship, stood uncomfortably side-by-side and exchanged testy barbs. Bush faulted Putin's record on human rights. Putin ridiculed Bush's contention that the U.S. is fostering democracy in Iraq.

Washington also worries about warming relations between Russia and China. The two nations held joint military exercises last summer. And both dragged their feet when the U.S. and France tried to get the U.N. Security Council to adopt a cease-fire in Lebanon after an Israeli withdrawal. Washington has been even more concerned about Russia's cozy relations with Iran. But the picture here is mixed. In early December, Russia joined the other members of the U.N. Security Council in sanctioning Iran because of its rogue nuclear program. The sanctions are not as tough as those that Washington sought, but Russia's support was still a welcome sign.

Despite concerns about Putin's repressive rule, it's clear he has transformed an economy that was faltering after the dissolution of the Soviet Union. After contracting by 40% between 1991 and 1998, Russia's GDP has grown at an average annual rate of 6.5 percent. The growth in oil prices (from $11 per barrel in 1998 to over $70 for much of 2006) was a major factor in this turnaround, which helps explain the drive to consolidate the industry under government control. Since 1998, Russia has increased its oil production from 5.85 million barrels per day to more than 9 million.

Other exports have also risen under Putin. In the past two years, export of metals increased 61%; chemicals, 28%; and machinery and equipment, 12%. A government that was unable to manage its finances in the 1990s has recorded five consecutive budget surpluses. In 2005, revenues exceeded spending by seven percent of GDP.

<u>IMPLICATIONS FOR BUSINESS</u>: There are many investment opportunities as Russia rebuilds its industrial base, develops natural resources, and builds a modern banking and financial services system. But investors must be wary about the widespread corruption. Though Russia needs and wants investment, it will be solely on its terms. Businessmen and women also need to keep a weather eye out for the possibility of serious political ruptures between Washington and Moscow.

INDIA: CHASING THE DRAGON

Look for India to be the big player on the global scene over the next decade, While its GDP growth rate of eight percent trails China's explosive 10.2% rate, it is good enough to rank India's economy as the world's second fastest in growth.

The spurt in India's economic growth over the past several years has been fueled by an upsurge in exports and manufacturing, which had languished in the past because of the New Delhi government's focus on a domestic economy based largely on agriculture and services.

India's annual growth in manufacturing output at nine percent and increasing, is close to overtaking its 10% growth in services. More than two-thirds of foreign investment in the past year has gone into manufacturing, not services. India Inc. is even going global as Indian firms begin to make significant overseas investments.

American and other foreign manufacturers have for years looked to China for direct investment, attracted by its enormous population and cheap labor market.

While the median age in China is 32.7 years, India's is a much younger 24.9. What's more, India's birth rate is higher. And, still more significantly, India will have more workers aged 20 to 24 by 2013, making its labor pool even more attractive to manufacturers.

This is key to future growth because manufacturing firms flooding into both countries are reporting serious shortages of both skilled and entry-level workers.

Additional assets for India are that English is a widely spoken second language there and that India, unlike China, it is a democratic country with a free press and a fair justice system.

India has long had a formidable information technology (IT) industry that has drawn major investments not only in plants and equipment, but research and development as well from such leading firms as IBM, Intel, Microsoft, Cisco, EMC, and Nokia.

Its manufacturing sector has increased dramatically with major investments from pharmaceutical, steel, cement, auto parts, tractor and farm implements, electrical appliances, and textile firms.

The recent increase in American investment was, in part, generated by President Bush's visit to India in 2006 during which he agreed to a deal with Prime Minister Singh that permits India to derive all of the advantages of being a signatory to the Nuclear Non-Proliferation Treaty without actually joining it.

The unprecedented deal made clear the Administration's desire to promote India's economic growth and increase its political influence in South Asia so it can serve as a democratic counterweight to China's growing economic and military power in the strategic region.

While India's welcome sign is clearly out for foreign investors, there remain significant hurdles for firms trying to do business there, including a weak transportation infrastructure, an inadequate power supply, a high illiteracy rate and weak educational system in rural areas, and an oversupply of bureaucratic regulation and corruption.

The government is seeking to resolve these issues, but doing so will take a great deal of time and money.

IMPLICATIONS FOR BUSINESS:

- India's huge market and its government's drive to attract foreign investment present an opportunity that global companies can ill-afford to ignore.

- Investors need to be aware of the Indian bureaucracy and the problems that India's weak transportation infrastructure and inadequate electrical energy supplies pose.

Despite its red tape, India's democratic government does, however, offer political stability that's conducive to long-term investment.

BROWN, SARKOZY & MERKEL

Angela Merkel is already Chancellor in Germany. If, as expected, Gordon Brown succeeds Tony Blair as Prime Minister in Great Britain and if Nicolas Sarkozy wins a hotly contested battle for President of France, look for Europe to move in a more parochial and nationalistic way—led by these three—and away from the EU (despite Merkel being Chair for the next six months). With the recent addition of Romania and Bulgaria the EU now numbers 27 countries. Relations between Britain and the U.S may also change since Gordon Brown may not want to tie himself (as Blair did) so closely to America.

__IMPLICATIONS FOR BUSINESS:__ Any diminishment in the EU's influence and prestige could negatively impact the value of the euro, which has been riding high against the dollar. But, by and large, this potential political realignment will not have any significant economic or commercial impact for U.S. business. All three leaders are also strongly pro-business.

GLOBAL WARMING IS HERE!

Global warming is, today, a stark reality—the debate is over!

Examples are everywhere:

- Arctic temperatures during the late 20th century were the warmest in 400 years;
- During the 20th century, the annual duration of lake and river ice cover in the mid and high latitudes in the Northern Hemisphere declined by about two weeks;
- Polar ice caps have decreased by about 40% since the 1960s;
- Sea level has risen 4-10 inches during the past 100 years;
- The biggest glacier in the Peruvian Andes was retreating by only 14 feet annually 20 years ago and is now retreating 99 feet a year;
- The surface waters of the Eastern Pacific have warmed by two degrees in the last 20 years;
- There has been a 70% decline in zooplankton, a five percent decline in fish populations, the wholesale death of seals and sea lions, and a 90% decline in the population of a species of sea bird;
- Over 35 million acres of coral reefs, home to over 35% of all marine life, have been obliterated and reefs off 93 countries have been damaged largely due to climate change;
- Since 1850, California has lost 80% of its coastal wetlands;
- As this Report went to press, Reuters reported from Canada that a giant chunk of ice larger than all of Manhattan has broken off from a vast ice shelf in Canada's far north and could wreak havoc if it floats westward toward oil-drilling regions and shipping lanes as the summer approaches.

Government, business, and individual citizens are energized to meet the threat as never before. Polls show that seven out of ten Americans now regard global warming as a "serious environmental problem."

<u>IMPLICATIONS FOR BUSINESS:</u> Any business not understanding this trend and failing to embrace it in their activities will suffer.

EXPECT EVEN MORE SCRUTINY OF EXECUTIVE COMPENSATION

Executive compensation will remain front and center in 2007.

Against a backdrop of corporate scandals involving cooked books, options back-dating, and other unethical, often illegal practices as well as steadily rising, multi-million-dollar annual compensation and severance packages, not to mention the normal quota of incompetence found in any calling, CEOs are no longer the darlings of the media,

Once treated by the media and investing public with the kind of awe and attention reserved for movie stars, many CEOs are, today, on the defensive as a legislative, shareholder, and public backlash has emerged. Still, the number of CEOs involved in headline-making payouts is relatively small compared with the total universe of corporate leaders in the U.S.

The coming proxy season marks the first time the extensive Securities and Exchange Commission disclosure rulings on executive pay will be reflected in company proxy statements.

The rules went into effect in mid-December, 2006. They require companies to describe more clearly and in more detail how their top executives are paid. Companies must provide more information on why specific stock-option grants were permitted and the lump-sum costs of retirement benefits.

The so-called compensation tables will be more detailed and comprehensive, including a summary pay chart for the top five executives that, over three years, cites dollar amounts for salary, bonus, and prerequisites totaling more than $10,000. Proxies must also have a "Compensation Discussion and Analysis," describing the compensation committee's objectives, policies, and decisions. This has to be certified by the CEO and CFO.

The media will have a field day and worker and consumer outrage will rise to new levels.

This, coupled with regulations intended to discourage manipulation of stock-option grants, mean that how, and how much, America's top corporate executives are paid will continue to attract a lion's share of attention from the SEC, the courts, regulators, Congress, and activists.

But complying with the new regulations will bring headaches to companies loath to be the first to disclose too much. There has already been considerable pushback from companies and entities such as The Business Roundtable, which says that tougher disclosure might unfairly drive down deserved executive compensation. The SEC received some 20,000 comment letters when the new regulations were announced.

There are, however, two areas the SEC has not regulated. One is that companies may report only the above-market gains from deferred compensation, not the entire amount. The other is that the company doesn't have to disclose the independence of compensation consultants and legal advisors to the compensation committee.

On the legislative front, Barney Frank, the new Democratic head of the House Financial Services Committee, has indicated he expects to hold hearings, for the first time, on this entire issue.

<u>IMPLICATIONS FOR BUSINESS:</u> The executive pay controversy won't abate. Deserved or otherwise, outlandish CEO compensation packages, especially after exposure in the media, generate resentment from the general public, shareholders, and employees, while doing little to enhance a company's image. This circumstance should be kept in mind at a time when the huge gap between the nation's wealthy and its fading middle class is greater than it has been since the l920s-or perhaps even the pre-income tax Gilded Age of the l890s.

Companies that comply beyond the letter of SEC requirements may find transparency can offer a measure of relief from angry constituents, but only if returns to shareholders are somewhat in line with executive pay.

It is ironic, however, that another class of American capitalists has been pulling down truly astronomic annual payouts—often in the nine figure range!—without very much attention being paid or controversy stirred up. We refer to the new mega-rich private equity partners and hedge fund managers whose incomes—even middle-level operatives—now often make some CEOs' compensation seem like chump change. Indeed, these firms operate largely in private, their incomes usually known only to the IRS. Yet, somehow, these latter-day Croesuses have managed to escape the obloquy and resentment that has befallen many a corporate CEO.

CEO PRESSURES MOUNTING

In 2006, the number of chief executives of public and private companies asked to leave their posts was nearly six every week—seven percent higher than the previous year when 15.6% walked the plank, also a record. In the first six months of 2006 alone, a total of 728 U.S. CEOs departed their corner offices. It may be the worst year ever for chief executive longevity. Over time, in fact, 50% of all CEOs are dismissed from their positions.

Two very recent headline-making CEO sackings, the forced resignations of Robert Nardelli at Home Depot and Hank McKinnell of Pfizer, were compounded by the outsized severance packages they received, $210 and $200 million, respectively, despite the lagging performances of both companies. Those bloated payouts instantly set off a shareholder, media, and political firestorm of anger and resentment.

Boards and investors are increasingly calling the shots, as are private equity firms, which now do not hesitate to dismiss poorly-performing CEOs. Data indicate that aroused investors, particularly, want short-term results and sustained growth. The recent flood of options back-dating scandals hasn't helped, either.

Those holding the top spots in public companies, on average, earned 262 times the annual pay of a typical worker even with uneven performance and sinking stockholder returns. In 1965, that ratio was 24 to one; in 1978, it hit a multiple of 35; and by 1989, it was 71 times the typical worker's annual pay.

Although women now comprise more than half the U.S. workforce, fewer than two percent of "Fortune 1000" companies have female CEOs. Female CEOs in the largest U.S. companies will continue to lag, in part, because more than half those firms have very few women in their top ranks. Currently, companies with the highest percentage of female executives include: publishing, transportation equipment, securities, healthcare, temporary help, airlines, food services, soaps and cosmetics, computer software, and pharmaceuticals.

<u>IMPLICATIONS FOR BUSINESS</u>: Short CEO tenures can sometimes create major problems. With just a year or two to show results, some chief executives, resorting to extreme measures to get results, often end up seriously damaging corporate performance.

Meanwhile, the avalanche of publicity that oversized CEO remuneration packages have been receiving has already unleashed a major backlash from the public, the media, labor, and politicos and created a public relations problem for many companies.

AMERICANS ARE DEEPER IN DEBT

For the first time since the Federal Reserve Board began keeping records on consumer debt versus consumer income, Americans owe more money than they make.

U.S. household debt levels have surpassed household income by more than eight percent.

A typical middle-income family earning around $45,000 a year has seen its debt burden increase by 33.1%.

This propensity of Americans to spend more than they earn has been fueled by credit card borrowing, low interest rates, and rising home values. Much of this spending covers skyrocketing health, housing, and educational costs.

Government data shows that credit card debt jumped from about $250 billion in 1992 to $804 billion last year. The increase in home equity loans is equally startling—from about $11 billion in 1995 to $243 billion last year. American student-loan debt has tripled in the past 10 years and, students graduate today with an average credit-card debt of $3,000, according to Nellie Mae, the principal student loan lender.

Many Americans may soon face such harsh economic choices as bankruptcy or foreclosure on their homes.

IMPLICATIONS FOR BUSINESS: Most worrisome is that rapidly rising mortgage defaults and foreclosures across the country could both lower all property values and finally undercut the housing boom, which has driven recent economic growth, paving the way for recession. Maxed out credit cards will also take a major toll on consumer spending, another key driver of the nation's recent economic growth.

TRIAL LAWYERS: DON'T COUNT THEM OUT

Know that trial lawyers, who have personally made hundreds of millions and cost the legal system tens of billions, will not stop.

At the top of their list: asbestos. Over the past dozen years, the plaintiffs' bar has driven more than 60 American companies into bankruptcy through asbestos litigation, at a cost to the nation in higher medical outlays approaching $100 billion.

Most of these companies never mined asbestos nor produced products made from it. Their only sin was to use asbestos products as insulation around a boiler or some other type of industrial equipment.

Employing mass screening methods, the plaintiffs' bar signed up hundreds of thousands of alleged "victims," the vast majority of whom had, at worst, minuscule exposure to asbestos; were not sick from any asbestos-related disease; and, most likely, never would be. As evidence of these excesses mounted and found its way into the media, revulsion grew.

Congress attempted, on a number of occasions, to put together a trust funded by the companies and their insurers that would compensate workers, who were truly sick from asbestos-related disease, but not those who were merely afraid they would eventually become sick. However, the trial lawyers, as major contributors to the Democratic Party, were able to derail that legislation in the Senate.

Plaintiffs launched a similar effort on the drug Fen-Phen, and now Vioxx is proving fertile ground as thousands of alleged "victims" have been signed up.

Indeed, malpractice litigation continues to cost the nation billions of extra dollars in medical costs for so-called "defensive medicine" driving doctors in certain specialties, such as obstetrics and neurosurgery, out of states with plaintiff-friendly malpractice laws. In Florida, for example, with its notoriously plaintiff-friendly state courts, there were more than 50,000 doctors practicing in 1999. Today, there are fewer than 32,000.

The plaintiff's bar is striving to circumvent tort reform statutes that have been enacted in many states and, equally as important, to create new litigation products and strategies to keep the cash register humming.

One of the more recent tactics of the plaintiffs' bar is to hire themselves out on a contingency fee basis to states and municipalities. This, of course, grew out of the hugely successful state tobacco litigation and master settlement, which netted literally billions for the trail lawyers and even more for the states. As a consequence, for the first time, trial lawyers–especially a handful of firms that reaped the lion's share of the tobacco windfall–are in a position to compete on a financial basis, if not outspend, their new corporate targets.

<u>IMPLICATIONS FOR BUSINESS:</u> Trial lawyers remain formidable, but there is enough experience now dealing with them to enable smart businessmen to often blunt their actions. Look for lawyers to try more and more cases in federal court, due to the inability, or unwillingness, of Congress to deal with this issue.

THE WORLD'S RELIGIONS: WHO BELIEVES WHAT?

In the 21st century, religion has increasingly evolved into a powerful, often dominant political as well as spiritual force. Unhappily, many of today's global conflicts have roots in warring, fundamentalist religious beliefs.

Yet, despite religion's numbers, power, and influence, perhaps one-sixth of the world's population say they do not adhere to any particular formal religion.

That still leaves more than five billion believers among an estimated 4,300 different faith groups and sects. These include:

- Christianity and its many branches (estimated 2.1 billion);
- Islam, covering Sunnis, Shiites, Kurds, et al. (estimated 1.3 billion);
- Secular/Non-Religious/Agnostic/Atheist (estimated 1.1 billion);
- Hinduism (estimated 900 million);
- Traditional Chinese (estimated 394 million);
- Buddhism (estimated 376 million);
- Primal-Indigenous Religions (estimated 300 million);
- African Traditional/Diasporic (estimated 100 million);
- Sikhism (estimated 23 million);
- Juche, the only government-authorized ideology in North Korea, but classified by Western sociologists as a religion (estimated19 million);
- Spiritism or Spiritualism (estimated 15 million);
- Judaism (estimated 14 million).

IMPLICATIONS FOR BUSINESS: Religion has become a major factor in elections and religious roots run deep in virtually every area of society. Carefully investigate all elements of a given region and its religious base before doing a deal that may be hard to back off from.

DO YOUNG ADULTS CARE?

Nationwide data confirms the waning appeal of news media to today's youth.

- Only nine percent of teenagers aged 12 to 17 and 17% of young adults aged 17 to 24 get their current events by reading newspapers. Even less—two percent—of each of these age groups reported reading news magazines.

- Out of both groups, 38% said they get their news from local newscasts, with 19% watching network news to stay up-to-date.

- 50% of teens said they spend at least two hours on the computer a day, with 24% of saying they spend more than four hours a day watching television. Many do both simultaneously.

- 10% of teenagers and 12% of young adults said they don't pay *any* attention to current events.

- Only 51.6% of the population aged 18 and over read a daily newspaper this year—down from 58.6% in 1998.

Even though it is easier than ever before to obtain timely information, teens and young adults are focusing their attention elsewhere. Today's teenagers and young adults simply consider themselves too busy to take the time to read or watch the news.

Thanks to cable television and broadband Internet access, younger people are multi-tasking almost constantly. Many of the teenagers interviewed by various publications about this issue reported watching movies on their computer; networking on sites such as MySpace.com or Facebook.com; downloading songs or movies; watching their favorite television programs; and doing their homework, often simultaneously, as a common occurrence. Few teenagers can identify the older anchors on the local and network news stations.

<u>IMPLICATIONS FOR BUSINESS</u>: Disinterest in current events leads to a similar feeling about elected officials and policymakers who create those events. Expect to see a drop in voter turnouts in the 18-24 age groups. This lack of interest will trickle down from the presidential level to gubernatorial, mayoral, and town board elections. Along with poor voter turnouts, also look for a decrease among the younger generation of those who aspire to become elected public officials.

Secondly, this lack of enthusiasm and interest could lead to increasing isolationist sentiments in this younger generation. When a country's people do not care about the events taking place on their own soil, they are not likely to care about events taking place in the rest of the world. This could, in turn, have a particularly crippling affect on the U.S. economy in a world where the global marketplace reigns supreme.

THE GROWING RANKS OF BLOGGERS

About 12 million American adults maintain a blog and about 57 million American adults read them.

Bloggers are a primarily young, racially diverse group, who view blogging as a hobby that they share with a few people.

While many well-known blogs are political in nature (so-called "citizen journalists"), 37% of bloggers use them as personal journals. Popular topics include politics and government, 11%; entertainment, seven percent; sports, six percent, and general news and current events, five percent.

More than half the bloggers (54%) are under 30 and are evenly divided between men and women. More than half live in the suburbs, a third in urban areas, and 13% in rural America. 60% of bloggers are Caucasian, 11% African-American, 19% English-speaking Hispanic, and 10% identify themselves as members of some other race.

52% of bloggers say they blog mostly for themselves; to express themselves creatively; and to document and share personal experiences.

IMPLICATIONS FOR BUSINESS: Bloggers influence in shaping public policy continues to grow. They now engage with virtually every major issue and the press, analysts, and other opinion leaders are paying attention. Businesses are also increasingly setting up their own blogs as another marketing channel.

EDUCATING THE AMERICAN WORKFORCE: 2007 WILL BE A YEAR OF BIG DECISIONS

After years of dwelling on ideological debates, the drive to improve the quality of America's schools finally appears ready to focus on real educational issues. It is a welcome change–one that the nation's business leaders, who have an enormous stake in ensuring a well-educated workforce, should strongly support.

The center of the debate will be in Washington where Congress will take up renewal of President Bush's signature education law, the No Child Left Behind Act. Co-sponsor Edward Kennedy, new chair of the Senate Education Committee, will play a key role, and politicians from both parties will maneuver to show voters they are serious about getting results.

NCLB's basic goals–enforcing rigorous test standards for public schools and closing the achievement gap between Caucasians and minorities–enjoy widespread support. But many critics believe the Administration has been simultaneously too aggressive in pursuing standards and too lax in providing the funds needed to meet them. There is evidence that some localities have fudged on math and reading scores to make it appear they are reaching the Act's targets, and several states have mounted legal challenges against the Act, arguing that it tramples states' rights.

As for the achievement gap between Caucasians and minorities, there is strong disagreement over how much it has narrowed under NCLB. President Bush insists the progress has been impressive. Critics say test results prove little has happened. Whatever the truth of the matter, everyone agrees the gap is still wide and more is needed to close it. Much of the discussion will focus on the persistent challenge of getting the best and most experienced teachers to work in the lowest-performing schools. Union seniority rules stand in the way of resolving this problem, and many observers believe that the only way to persuade veteran teachers to leave the safety and comfort of middle-class schools is to offer them substantially increased salaries.

Higher teacher pay is one of the major proposals of a report released last month by a blue-ribbon, bipartisan panel, called the Commission on the Skills of the American Workforce. The pay for starting teachers should be $45,000, the commission recommends–a $20,000 increase over the current average–and climb to $110,000 for experienced teachers who work year-round. Among the panel's other far-reaching proposals are:

- Starting school for most children at age three.

- Ending high school at 10th grade. Vocational students would go on to technical schools or community colleges for skills training. Academic students would take two more years of advanced courses in high school and then enroll in college as sophomores or juniors.

- Removing control of school finances from local districts and shifting it to the state level.

- Empowering districts to turn management of schools over to independent contractors, including private companies.

- Setting up "personal competitiveness accounts" to cover the cost of retraining citizens whose jobs have been phased out, an acknowledgment of the impact outsourcing is having on the nation.

Like the renewal of NCLB, the Commission's proposals will be the subject of serious debates in Washington in 2007. Some Commission members—notably, New York Mayor Michael Bloomberg—expect the outcome to make sweeping and lasting changes in America's educational system in the same way that a predecessor report, "A Nation at Risk," did when it was released in 1983.

The driving force behind the push for reform is the widespread opinion among educators, elected officials, and business leaders, that unless the U.S. rapidly raises school standards, it will fall behind other advanced nations that are doing a better job of preparing their young people to compete in the global economy. In the words of Marc S. Tucker of the National Center on Education and the Economy: "There is this growing mismatch between the demands of the economy and what our schools are supplying."

The problem is not that all schools are failing—far from it. Many American high schools do a good job of educating the best and brightest, and the number of qualified applicants to the nation's top colleges increases each year. The challenge is that about one-third of students nationwide either can't keep up with the pace or are trapped in low-performing schools. Most of them are African-American or Latino, hence the achievement gap. But many Caucasians fall behind, too. John Gutfreund, former CEO of Salomon Brothers, has argued that "underclass education is today's great challenge."

The drive for reform will collide, however, with several persistent obstacles. Politically influential teachers' unions dislike both merit pay and the idea of dissolving the link between seniority and school selection. They are also sure to fight any move to privatize public schools. Local public officials are likely to oppose the proposal to bump financial control up to the state level as well as other measures that upset the status quo.

Money could overcome a lot of these obstacles. For example, teachers might make concessions in return for bigger paychecks, and local districts may relinquish power to the state if it means more school aid. The question is: Where would debt-ridden Washington and cash-shy states get such sums?

Counter-balancing the entrenched forces are two powerful agents for change. One is the business community, which, as the nation moves deeper into a high-tech service economy, feels the need for educated, skilled workers. Some analysts have even warned that unless schools are improved, corporations will have to become the nation's de facto education system.

The other source of support for reform is the middle class and, especially, the upper middle class. In the past, many parents from these economic groups solved the problem of failing public schools by sending their children to private schools. Now, with private school tuitions rivaling those of Ivy League colleges, many parents are looking locally. Their political muscle could push public officials to get serious about educational reform whatever the budget impact.

<u>IMPLICATIONS FOR BUSINESS:</u> Look for education to emerge as a hot-button issue in 2007, especially as the presidential candidates stake out their positions for 2008. Farsighted business leaders will want to consider backing reforms like those proposed by the Commission on the Skills of the American Workforce, even if it requires shifting federal and state funds away from other spending areas. The alternative could be a future shortage of well-educated workers and a resulting loss of U.S. competitiveness—either that or the expense of creating corporate-run colleges to make up for the school system's failings.

THE LONG FIGHT AGAINST AIDS

The scourge of AIDS continues to fester and will be with us for a long, long time. There are now 39.5 million people in the world living with HIV, 4.3 million of whom became infected in the past year, according to the United Nations. The more than 2.9 million deaths from AIDS in 2006 was the highest in any single year. In the 25 years since the first case of AIDS was reported, 60 million have been infected, of whom 25 million died. It is the world's leading cause of death of both men and women between the ages of 15 and 59.

Sub-Sahara Africa continues to be a major center of the AIDS epidemic. Two-thirds of all adults and children with HIV live in sub-Sahara Africa and almost three-quarters (72%) of all adult and child deaths due to AIDS in 2006 occurred in that region of Africa. Regrettably, only a small fraction of AIDS-infected children are being treated.

However, the growth in HIV infections and in AIDS is by no means limited to sub-Sahara Africa. In the past two years, the number of people living with HIV increased in every region of the world. In Europe and Central Asia, infection rates have risen by more than 50% since 2004.

Nevertheless, there is some good news: The United Nations reports a decline in the prevalence of AIDS in eight African nations–Botswana, Burundi, Ivory Coast, Kenya, Malawi, Rwanda, Tanzania, and Zimbabwe. Across Africa, at least 60,000 patients are getting AIDS therapies distributed by Doctors Without Borders.

The U.N. and Group of 8 industrialized nations have set as a goal universal access to AIDS medicines by 2010, with 9.8 million people in treatment, although a number of AIDS activists say we are falling behind in meeting that goal.

IMPLICATIONS FOR BUSINESS: AIDS will continue to be a major health problem for a long time in whatever part of the world you do business and, as such, needs urgently to be addressed by businesses as well as governments, world health bodies, and NGOs.

IT DIDN'T HAPPEN

Chicken Littles, never lacking in certitude, are always with us and sometimes end up with lots of egg on their faces after barrels of money, endless planning, and tons of newsprint have often gone down the drain. Just for starters, remember:

- Y2K and the billions spent preparing for a crisis that never happened;
- The Asian Flu epidemic, which has yet to materialize and the public appears not to be overly concerned today;
- The gloom-and-doom Wall Street prophets who not so long ago saw the Dow plunging to 1980s' lows;
- Weapons of mass destruction in Iraq;
- The "End of History," courtesy of Francis Fukuyama;
- The "paperless society."
- The digital book revolution.

IMPLICATIONS FOR BUSINESS: Evaluate everything and make sure not to get caught up in a tide of foolishness based on faulty reasoning by those with too easy access to the media.

CLOSING QUOTE

> "Let us define truth, while waiting for a better definition,
> as a statement of the facts as they are."
>
> -- Voltaire