

## Information: truth, lies and entertainment

### 1. No news is good news?

It would hardly meet the expectations of our readers if, instead of a completely new, freshly written investment commentary, they just found another copy of No. 230, published at the beginning of July, in their letterbox. The bank in St. Gallen would be accused of a lack of ideas and advice, and the unattractive notion would soon occur that this situation might apply not only to what was being written, but also to what was being thought and done by these bankers and asset managers. That alone is obviously sufficient motivation to write an investment commentary, regardless of the situation.

Regardless of the situation. For it is indeed the case that over the past couple of months little enough – too little, it almost seems – has happened on the financial markets, and in the world at large. The remarkable stalemate between fairly attractive conditions and the diametrical opposite that we described six weeks ago has if anything become more pronounced over the holiday period. It is still unclear how sustainable the economic upturn in the USA will prove to be. Nobody still has any idea whether globalization-driven deflation will prove stronger than the flood of liquidity that is generating inflation anxiety in the western industrial nations. As a result, it is still unclear to what extent the central banks will raise interest rates. Was there a real change in the trend in spring 2004, or were the rises in interest rates effected by the Swiss National Bank, the US Fed and the Bank of England just minor cosmetic surgery? And further: will the (overall impressive) growth in company profitability continue in the months and years to come, or is a deterioration already pre-programmed? Will the price of oil settle down again after the sharp rise since the beginning of 2004, or are we at the start of a high-price phase, with prices of perhaps 100 dollars a barrel or more? Lastly:

has international terrorism really calmed down, or are we to expect another, even more violent strike by al-Qaeda in the near future? In consequence, how and by whom will the global power of America be governed over the next four years?

Uncertainties on every side, but few gradations, little subtle differentiation; much rather, it is a matter of – genuinely diametrically opposed – alternatives wherever we look. The financial markets are behaving accordingly. Low volumes, driven almost entirely by so-called professional players – above all hedge fund managers, apparently – all frantically seeking the last inequalities in the market. The rest of the financial world is staying under cover. Those who have money are keeping it in the form of cash. This has the disadvantage of low nominal returns, but also the advantage that there is a low probability of loss. The excitement in the market that we really experienced to excess over the past couple of years has given way to a paralyzing calm, described by many, suggestively enough, as the calm before the storm. At the moment, most indexes are drifting sluggishly sideways or backwards.

So, for once, the lack of news looks to be more of a problem than a blessing. News; that is, reports of changes in the real state of the world, the global economy or the aggregate of the financial markets. Obviously, a temporary excess of political or economic uncertainties will result in the sort of excitement that has indeed characterized the last few years. The advantage of these sorts of development, though, is that they both set a direction, and also subside again quickly. What we are currently experiencing – or rather, not-experiencing – is a lack of direction that generates a paralyzing uncertainty and whose end, to make matters worse, is still not in sight.

As a small consolation for becalmed investors, they are not helplessly exposed to continuing crab-like progress on the stock exchanges. Even under these conditions, structured products of the MOM<sup>®</sup> variety (Money-or-Market, known in Germany as *Discount-Zertifikate*)

continue to generate returns that provide a certain buffer against price drops in a falling market. As mentioned, the consolation is, however, small, because the low market volatility, i.e. the lack of excitement, means that the premiums are also fairly low. Nevertheless, no response at all to this situation would be considerably less attractive.

## 2. News – but what news?

Now, it might be countered that there is really no lack of news of any kind. Daily front-line reports from the Americans' battle in Najaf, reports of ex-president Carter's personal experiences as an election observer in Venezuela, Monday demonstrations in Eastern Germany, Olympic jubilation in China, outstanding half-year results from companies such as Geberit (share price since the start of 2004: +43%), Saia-Burgess (+45%) and Straumann (+34%), less good news from Ciba (-18%), Converium (-61%) and Unaxis (-30%), reassuring words from Fed Chairman Greenspan in the latest "beige book" – what more could one want? This is indeed all news. But are they reports about relevant matters, or about relevant changes in these matters? On receipt of this information, do we know more, are we better informed?

That the occupation of a country, and in particular a country so different in cultural, religious and political terms, will involve a number of more or less bloody incidents will, come as a surprise only to those who, for lack of any historical knowledge, remain unaware of the unpleasant nature of war in any form. The reality is different and tougher. "Clean wars" are not merely an illusion, but a contradiction in terms, even if utterly justified (whatever the significance of this ethical concept may be when applied to the killing of people...) and fought with the approval of the entire international community. For the same reason, the news of maltreatment in Iraqi jails also comes as no surprise. What would have been a surprise would have been the non-occurrence of such lapses – in short, an army that remained disciplined in such a situation. That would have been a relevant piece of news.

The plebiscite in Venezuela, or rather its result, which could only be problematic, whatever happened – can this news shake our conviction that the country is ruled by corruption, regardless of whoever is in power? The Monday demonstrations, the result of a social policy that distributes privileges on tick – are they not an

almost inevitable consequence, and again, would not their non-occurrence have been the real surprise? Or that some companies manage to achieve double-digit growth after deplorable results in the previous year, while for others the horizon grows darker again – what else would one expect, given the remarkably diffuse state of the economy? And that Greenspan talks as if he has everything under control – who would seriously expect anything else from him, even in the knowledge that his toolkit for keeping everything under control is fairly limited?

Information conveys knowledge, and this knowledge reduces the constitutional lack of knowledge, or uncertainty, of people and their social environment. From this perspective, little of the news that has circled the world in recent days and months would qualify as "information". It has not significantly enhanced our knowledge, nor has it raised our spirits, not to mention inspiring us to any meaningful action. The result, among other things, is low market volatility.

We may have to accept the fact that for the time being, the world remains in a non-committal state. But it might also be the case that, for whatever reason, we do not receive the important news, or that we are not able to identify and interpret the relevant reports. It could also be the case that the provision of news has changed so much in recent years that it is becoming increasingly difficult to gain access to genuinely relevant facts – i.e. to information. That would mean increasingly deceiving oneself or allowing oneself to be deceived – a most undesirable situation for investors and their advisers in particular. Sufficient reason, then, to give consideration to the nature of information and the economics of its distribution.

## 3. Information and "information-flood"

Firstly, at a fundamental level, information – however defined – is, in economic terms, a public good. For unless news is whispered directly into a very private ear, and the secret subsequently kept absolutely, it can be used – consumed – by an indefinite number of people without being exhausted. A single copy of a newspaper can be read by several people, a radio or television programme shared by many people, and a web page visited by an indefinite number of people.

This has two results. Information seems to be something of a "free lunch". People are not prepared to pay as much for it as they would for a private good that, like an apple, is con-

sumed once used or, like a car, is reserved for individual use. As if it costs nothing to generate information! Consumers of public goods are often freeloaders, in various ways. Accordingly, producers of public goods apply various techniques to make ends meet economically. They try, for example, to privatize the goods through limitations on access (restricted access to Internet pages, limited editions of lithographs, etc.) or by preventing copying (copyrights, patents, etc.). Sometimes they are able to finance their production through fees or taxes levied on the public (radio and television licence fees, often in combination with an effectively monopolistic franchise). Or they try to subsidize their product via a by-product (for example, newspapers via advertising or cultural activities via sponsoring). If none of this works, the result is an under-production of public goods, compared to the situation that would exist if they were private ones.

Interestingly, however, in the area of the public good “information”, or rather that which is often described as such, there is no under-production, but rather an increasingly obvious over-production. There is a general complaint that the flood of “information” is becoming overwhelming, that it is no longer possible to see the wood for the trees, that one needs more and more (scarce) time to deal with it all, and so on. The volume of reports about events of all sorts and qualities has undoubtedly risen exponentially in recent times. This can be demonstrated in terms of the bits and bytes that flash round the globe, second by second, day by day, or the number of Internet home pages, or the growth in storage capacity. There is a flood of information, and it may be assumed that this information is generated with the intention of reaching at least somebody.

The question is, however, whether this is really information as defined above. Objectively speaking, is uncertainty reduced and knowledge increased? Is certainty enhanced? Are the reports and interpretations relevant, or do they merely exist? Are they in fact just there, without being of, or achieving much significance? Can we in fact describe this as a flood of information? Is it not rather a flood of bits and bytes, letters and characters without much relevant content? Anyone who, over the past few years, has learnt the value of the Internet also knows, from using Google, that enormously powerful search engine, that it is becoming increasingly difficult to get past meaningless or indeed downright false, forged or

ripped-off content in order to access the right, important, relevant pages.

But even then, when the information content of the search results seems to be in order, can we so unconditionally accept the blessing of free access to the truth? For what is the motivation that lies behind so-called correct content? Why was it made available on the Internet? Out of pure altruism? Or rather for a specific purpose? What is the structure of the immense amount of content that has been generated in the very few years since the Internet became publicly available?

In our view, the explosion of available “information” in principle represents an enormous and ever-increasing volume of news and interpretation generated by people in order to have an impact on its readers, to reduce uncertainty or to increase certainty; in other words, to set the information process in motion. With the Internet and other means of communication, it has become possible to reach an indefinitely large number of people very cheaply.

“In order to have an impact on its readers” can mean many, very different things. Commercial pages attempt to motivate the reader to a transaction with financial consequences. Scientific websites aim to influence the progress of scientific discussion by means of their own contribution. Educational sites attack lack of knowledge head-on, and thus pursue idealistic goals. And there is also an infinite number of personal profiles, whose purpose could perhaps best be described as trying to achieve the most appreciative perception possible by the public. There is not a business – right down to one-man bands – that does not advertise its advantages on its homepage. No public authority that does not proclaim its assiduity in providing services, its “customer proximity” and its values via the Internet. Indeed, things will soon have gone so far that responsible citizens will be well advised to expose themselves and their family, including pets (with picture series: “Bonzo takes a walk”), to the public gaze, for transparency on the private sphere naturally provides information about anything else that might be of interest.

Nothing against the Internet; absolutely not! It has, over the last ten years, really made our lives easier in many ways, and has given less developed parts of the world the opportunity to get access, at last, to knowledge that was previously reserved for the very select elite that could send their children to English boarding schools. There can be no doubt that the Inter-

net is *the* engine of globalization. But nevertheless – or rather, precisely for this reason – it is always necessary to be aware that this immense variety of available news and its interpretation is in fact a supply in the economic sense. Internet sites with no economic calculation behind them are very much the exception. This economic calculation may be of purely financial nature, it may be near to pure and obvious advertising, but it may also transmit a kind of official-looking, apparently objective presentation, that appears to be genuine information, but whose real purpose is to exert a positive influence on the public.

This indeed is the problem with the excessively generous supply of “information”: it purports to offer objectivity and truth whereas in fact it is more a case of presenting the positive facts and omitting, glossing over or even embellishing the negative. Rather in the way that portraits of well-known people used to be painted – based on the most flattering image that could possibly be held to reflect reality, so that walking through the museums today, we are amazed at how many beautiful people there must have been in the past. In other words, the Internet provides “information” with an enormously euphemistic bias. The information value is accordingly lower than one would like, or still worse: the combination of genuine information with disingenuous embellishment results in a far too rose-tinted view of things. This can lead to a general, subliminal scepticism.

#### **4. The great justificatory cartel**

If we think further about the “information” supply, it soon becomes clear that what applies for the inexhaustible supply on the Internet might also apply to another aspect of public communication. It is noticeable how communicative most figures in public life have become. There was a time in Switzerland when communiqués from the government or any of its individual members were a real event. Individual speeches or comments were remembered for years. Thus, in 1939 Federal Councillor Obrecht, from Solothurn, released the nation from a state of festering uncertainty with the blunt proclamation: “Wir werden nicht ins Ausland wallfahren gehen!” (“We’ll make no pilgrimages abroad”) This, just at the moment when, after Benes’ journey to Berlin, Czechoslovakia had lost its integrity. By contrast, an overpolished, but otherwise remarkably statesmanlike speech by the then Federal President Pilet-Golaz in 1940 had a pernicious

effect on internal relations within Switzerland, as for years it was regarded as being treasonable in tone. Whatever the verdict of history may be, looking back one thing is clear: previously, ministerial statements tended to be remarkably significant. This is by no means the case today. However, the inflationary volume of statements by current government ministers has the natural advantage that the individual rhetorical occurrences need no longer be taken quite so seriously – or indeed be paid any attention at all, perhaps.

This inflationary volume of statements is measurable. The number of “information officers” in the Swiss Federal administration has now reached 286. (Our inquiries show that this involves over 500 people, as obviously some are part-time positions – whatever that means.) This is remarkable in itself, but matters become even more remarkable when we look at the individual departments. The Department for Defence, Civil Protection and Sport (VBS) alone has no fewer than 127 people employed in the information area. It is tempting to suppose that there may be an inverse relationship between the objective importance of the task and the number of “information officers” employed. In the Justice and Police Department there are just 22 positions, though according to the new minister these could all be replaced by a single good secretary.

When government ministers hold forth in such inflationary fashion, when a superfluity of “information officers” are obliged to explain the workings of the government and the administration to the doubtless important, but numerically limited Swiss population, when it may be assumed that a similar informational euphoria is rife at cantonal and municipal levels, then we must really ask what in the world governs such a supply, what calculations lie behind it, and what consequences we should draw. The first is undoubtedly the inadequate control of state dissemination of information and the costs involved through the creation of such positions. But there is also another aspect. Most state-supplied services are clearly not a response to a genuine, and priced, demand. The more expansively the state fulfills its tasks, and the further these diverge from the classic tasks of the state, the greater, obviously, becomes the implicit pressure for justification.

This, of course, not a Swiss speciality. When we consider the many statements by the German Chancellor, on all possible topics, and their inconsistency over the brief period of one leg-

islative term, it is hard to avoid thinking of a “justification machine” for past and future blunders. That credibility is lost in the process should come as no surprise.

What is said is one thing; what goes unsaid, another. Excessive discussion of secondary issues can also be used to distract – and this is obviously what happens. Thus, for years, the Swiss government has avoided any effective debate on one of the most urgent questions facing the country – its integration into an increasingly large and complex, and obviously more and more centralized Europe. This is because it realizes that the debate will be disagreeable to the extent that all the strategic options involve substantial disadvantages. So it prefers to remain silent, and take the apparently harmless route of a bilateral approach. Here too, of course, in the avoidance of disagreeable topics, Switzerland is by no means alone. How long has it taken for the problem of an excessively rigid labour market to be seriously discussed in Germany? How long did it take for people to give remotely serious attention to the problem of demographic change in the debate on pensions? Not even the presence of an opposition helped to make these topics the subject of public debate. Why? Because in these circles too, silence was the more attractive option. Best not to start any hares, that might one day come boomeranging back as elephants.

So then, there is a mainstream of justification, trivialization and concealment. In countries with no opposition, such as Switzerland, or with a purely nominal one, such as Germany, this mainstream may be more coherent than in countries where launching ideas and alternatives is part of everyday politics. Whether this is really so absolutely the case may, however, also be doubted, in view of the unbelievably crass content currently being delivered by the American election campaign. In other words, it is as if, independently of the actual system of government, extenuation is being produced en masse. Interestingly enough, government circles seem to have little problem in disseminating such justificatory, trivializing and disingenuous statements. The media present themselves superficially as critical, particularly when it concerns individual people, but in matters of substance, they reveal themselves primarily as faithful representatives and disseminators of the mainstream.

Alternative positions have a hard time. In Switzerland, the initiators of the “Avenir Suisse”

think tank, set up five years ago, were amazed at the very sobering lack of attention paid to the undoubtedly high-quality theses and positions they represented. Unsurprisingly, they sought the possible mistakes in their own structures and approaches, and overlooked the fact that they were up against a highly impenetrable justificatory cartel, made up not only of the government and the media but also, and specific to Switzerland, of the large number of associations of various kinds. This cartel is based on a finely balanced system of give and take, and regards all issues of real substance as tiresome interference with its own interests.

This has a concrete impact on the Swiss information and media system. Switzerland was, and still is praised for the diversity of its press. In fact though, there are only very few products that generate or disseminate information that is really relevant and really important. They can be counted on the fingers of one hand. We can probably generalize, and state that there is a causal link between the modern distributionist state, and its justificatory cartel consisting of ministers holding forth in inflationary fashion, information providers embedded in the administration, media oriented to the mainstream and lobby organizations concerned with maintaining a dynamic balance. For the information system, this means a systematically suboptimum provision with really relevant information. This can call into question the system’s ability to react to new situations and challenges. And individuals must be aware of the inherent bias of any excessively positive interpretation.

##### **5. No market for scepticism?**

If both the extremely powerful Internet and the apparatus of the traditional media have a rose-tinted bias, why is such stuff swallowed so uncritically by consumers? What about the demand side of the information system? Are media consumers systematically “underinformed”? Are they happy to be left in the dark, consciously or unconsciously?

Trying to render otherwise inexplicable phenomena plausible on the basis of irrational behaviour would be a dangerous business, because in terms of logic this means operating in the area of tautology, which leads nowhere. In our view, there are indeed possible explanations of why systematically sugar-coated interpretations fall on fertile ground, at least for a while. Firstly, it is not the case that consumers invariably want to be informed. They will not

always want to reduce their level of uncertainty, because they are not disturbed by it. They are more interested in amusement and entertainment, for which systematically sugar-coated “information”, lightly spiced with a few indiscretions and intimate details concerning prominent personalities, is eminently suited. We are thus well advised not to overestimate the information content, and the mandate that goes with it, of certain media. In the case of television, and certain print media, the proportion of information can be very low. The ratio will hardly differ for the Internet, in purely quantitative terms. It is said that globally, 60 percent of all Internet pages contain pornographic content... We should be under no illusions about the nature of man.

Secondly, mainstream thinking is not a priori reprehensible. Economically, it is efficient so long as it does not threaten its own position. What is the point of the laborious process of reducing uncertainty if this uncertainty has no real consequences? Why, for example, should a pensioner be concerned about the future of the pension system when in all probability his own pension is safe? Why should a consumer worry about the flood of overall slightly rose-tinted news, so long as he or she is not personally affected by this rose tint? Better to swim in the mainstream, and even profit from it a bit, than to impair one’s own quality of life with sheer anxiety about the collapse of the system. That is entirely rational, and we are obliged to accept that the demand for relevant information is probably not as great as we might wish it were from an idealistic perspective. For this reason, quality media will never have very high circulation figures, and will always have to be financed differently from those that are oriented to the dissemination of the mainstream.

Nor, though, should we underestimate the consumers of news and interpretation. For they are quite capable of discounting the inherent bias of the information supplied. When the Swiss electorate once again throws out a referendum proposal against the unanimous recommendations of the government, the administration, diplomats, parties, the media and the associations, then just such a discounting process has occurred. When this happens, the mainstream has been breached and the justificatory cartel disavowed. Overly self-important information on the Internet is probably treated in a similarly realistic fashion. When it comes down to it, consumers are sceptical, and because the

Internet is so open and accessible, they are very likely to be able to gratify their scepticism.

#### **6. Business news – also overoptimistic?**

It might be assumed that when it comes to business and the economy it would be significantly more difficult to systematically disseminate excessively positive news via the media and the Internet. Indeed, that in contrast to the state and social sectors, the markets would provide a continuous valuation, so that corrections to the picture would be possible at any time, and that these would bring with them penalties, in hard cash, for those who had been wrongly or inadequately informed. That is the basic assumption of market efficiency.

There are, however, weighty arguments that, while not calling this assumption fully into question, at least set limits to it. Firstly, we must be aware that there is in the capitalist economy a group of players who have an immense interest in things being seen to be more rose-tinted, more attractive and more promising than is warranted in reality, and that this group is entirely ready to sacrifice future development potential in order to portray a sugar-coated present. This is the group of players who do just as much for their enterprise as suffices for them to remain acceptable, and for the rest, optimize their own interests. This group – readers will not find it difficult to divine that we refer to management – naturally has an immense interest in the justification of their own actions and the concealment of disagreeable facts, and will make every effort to find ways and means to ensure that these justifications fall on open ears.

These above mentioned “ways and means” do exist. The incentive structure in large areas of investment banking and financial analysis is so organized as to support rather than uncover both overoptimistic presentations and management’s efforts at justification – for the goal is, after all, to find a buyer for their recommendations. If, as often happens, they are also integrated into a vertical structure, so that there is, so to speak, an uncritical pipeline all the way from investment banking down to the individual client portfolio, then there is nothing to stand in the way of the euphemisms generated by company managements and disseminated by the financial market media. Supply-oriented financial analysis (sell-side analysis) has an inherent systematic bias to rose-tinted interpretation.

Nor, though is the consumer of financial market information entirely innocent when it comes to this tendentially over-positive picture. Being continually informed is an expensive and time-consuming business – and also, when one is for a longer period in possession of insights that go against the trend, nerve-racking. For then, one is always “wrong”, a state of being that neither investors nor their advisers particularly enjoy. And one does indeed suffer losses for a certain period, while those who blindly follow the trend are “right”, up to a certain point. This is surely why, despite all the efficiency of the financial markets, relevant information often remains long unregarded, which repeatedly gives rise to the development of bigger or smaller bubbles.

In our view, we should have no illusions whatsoever about the call for greater transparency and the efforts being made under the catchword of “corporate reputation”. However welcome all this is in principle, it is equally obvious that it opens up a new field of activity for the regulators (which they will also be able to justify ...), that battered audit firms will discover a new consultancy Eldorado, and that the guild of managers will, under the title of transparency and corporate reputation, simply discover the next vehicle for their attempts at justification.

### **7. No news, but a crisis of confidence**

The late 1990s were largely characterized by behaviour on the demand side that is easily explicable in terms of game theory, combined with justificatory and self-profiling pressure on company managers and the systematically inherent euphemism of investment banking and sell-side analysis. Although information began to amass that “it can’t go on like this” – that is, that the profit expectations derived from the share prices of high-growth technology stocks could never, ever be met – the trend continued steadily, and those who labelled the obvious exaggerations as such were regarded as daft.

The last three years have given rise to a great deal of disillusionment. Indeed, it rather looks as if, after pink and following the trend, a great deal of black has been applied. Normalization got under way in March 2003, and lasted about a year. What we have witnessed since is a mood of total scepticism and a refusal of trust. Essentially, people believe absolutely nothing. Herein lies our explanation for the singular stasis that has reigned on the financial markets for the last couple of months. A shrug of the

shoulders; “So what?” is the only reaction to any news that reaches us – and there is hardly a single report that contains real information, relevant to the taking of action. It would need far more striking events to bring an end to this paralysis of our receptiveness. There is, though, as we mentioned above, quite enough potential for this, of both positive and negative nature.

As a relatively small bank and overall fairly insignificant player in the apparently infinite universe of the financial markets, we have been reflecting on the general situation with regard to information generation and evaluation over the past few years. We certainly have no desire whatsoever to be part of the justificatory efforts of the managers of any companies. Still less do we wish to serve the purposes of biased investment bankers and financial analysts. And in the social, political, and specifically the business/political arenas, we cannot join in the chorus of euphemistic dogma generated by the system. The interests of our clients demand an independent and soundly based opinion, in all areas, and one that is falsified by no special interests.

We have recently completed the build-up of our Investment Office, which is oriented on clear economic criteria, and to the maximum possible extent evaluates hard facts about the companies and sectors being analyzed, and not third-party opinions. The bank’s expectation of this group is not that it will, with a golden finger, point to all the possible top stocks for the next half-year – this would be seriously frivolous. Rather, it is that it should generate a list of possible investments, of which it can be said with a clear conscience that they meet judicious quality criteria. It may be admitted that our experiences with the unhappy Swissair made a significant contribution to this task definition.

Further, the prices of the stocks analyzed should not be driven so high, by whatever outbursts of enthusiasm on the markets, that even value-creation of the highest quality would never be sufficient to meet the market’s expectations. And we do, of course, take a look at corporate governance, though we do not assess this in a formal sense – not by the number of officers and committees deployed – but mainly by the probity of the reporting. This can be detected (or indeed, on occasions not detected) above all in the small print of the annual report.

What we do is known in asset management jargon as “buy-side analysis”. Financial analysis not as part of the sales apparatus of an invest-

ment bank, but as the – hopefully intelligent – front line of the demand side: the buyers of stocks, the investors. One out of many American studies with similar results shows that the buy recommendations of independent research firms were systematically ahead of those of the investment banks by 3.2 basis points on a daily basis. For the period from 1996 to 2003 this represents an annualized additional return of 8 percent. Another study in the Journal of In-

vesting shows that the stock recommendations of the most important investment banks generated significantly higher risk combined with systematic underperformance. With the business policy we have adopted, we should at least find ourselves on the right side.

KH, 23.8.2004