PUB CA 18

**Q. Pg. 46, lines 14-22 - Given that the simple CAPM formula is not appropriate under current conditions, as you note, did you consider using other primary ROE estimation methodologies which do not need to be adjusted? If yes, which methodologies did you consider? If not, why not?**

A. This question makes a statement that is not correct. Nowhere does Dr. Booth state that the CAPM formula is incorrect. Dr. Booth states that a simple mechanical application of the CAPM results in estimates that are not appropriate at the moment. He is still relying on the CAPM formula only more judgment is required at the current point in time since the capital markets are dominated by the actions of the global policy maker. The only other primary method of estimating fair rates of return is the DCF method. Dr. Booth explains the historic problems with DCF versus risk premium models on pages 57-62 of his testimony.

Dr. Booth judges DCF estimates to be most reliable when applied to the market as a whole, they are then best used to validate the expected return on the market in the CAPM. This is what he does in his evidence. Individual DCF estimates are generally unreliable unless a variety of growth estimates are used, which in turn are stress tested against GDP growth expectations and the ability of the firm in question to generate these types of growth expectations in the past. All too often reliance is placed on a few analysts who are known to be optimistic in forecasting growth rates that have not hitherto been achieved.