

MARCH 1995

Quality Is Back

The markets surprised and disappointed most investors in 1994. The biggest surprise was the rise in interest rates, which caused losses to long term bond investors in the 8-14% range. Even the traditionally conservative utility investor witnessed a 20.8% decline in value. International stocks performed well until the final weeks of 1994 when the Mexican currency devaluation served to eliminate earlier gains.

The steady stream of negative commotion in 1994 caused a welcome "flight to quality" thus far in 1995. Our clients have benefited from individually purchased bonds with high ratings and short maturities. In addition, our core equity holdings include McDonalds, Merck, Hewlett-Packard and General Electric, all of which are producing superior worldwide earnings and are priced remarkably well.

Presented below are our views on key market issues.

INTEREST RATES

We began predicting higher interest rates in late 1993 and early 1994. Our clients' municipal, corporate and government bond portfolios have held their value well since then as average maturities were trimmed to 3-5 years in anticipation of rate increases. Clients gained further comfort from "laddered" maturities of bonds which assure a satisfactory "cash on cash" return. We believe that the odds favor higher interest rates in the coming

decade and have positioned portfolios accordingly. We sense that the Fed must increase interest rates to allow the Treasury to find buyers of our ever increasing debt. As the recent drop in the value of the dollar illustrates, the world markets, and not necessarily the Fed, dictate interest rates. We view the recent stabilization in interest rates as temporary and encourage investors to liquidate bond portfolios with average maturities over ten years.

STOCKS

Despite the drop in the bond market in 1994, high quality equities were relatively flat. We read a great deal into this relationship (i.e., bonds down, but stocks flat) and attribute stable stock prices to the underlying strength in corporate earnings. We remain encouraged by domestic companies with strong international markets (i.e., those mentioned earlier). We also invest in companies which own sizable "real" assets which become more valuable in an inflationary global market place. Examples include Alcoa (aluminum), Westvaco (paper/timber/lum-

ber), Norfolk Southern (railroad with coal reserves) Mobil and Amoco (oil reserves).

INTERNATIONAL EQUITIES

The global investment market has been negatively influenced by rising U.S. interest rates. However, the prospects for improving economic conditions in Europe and Japan, as well as explosive growth in developing economies, causes us to be bullish on world markets. Mexico is in the midst of a financial slide. However, the United States is clearly Mexico's "big brother" and our support will likely result in a long term positive trend in that country. Troubles in Mexico affirm our recommendation to avoid "country specific investments", in favor of funds which diversify among many countries.

OTHER EQUITY INVESTMENT VEHICLES

We continue to recommend appropriate exposure to aggressive growth and value stocks. For this exposure, we research specialized low-expense funds with long term track records.

In conclusion, 1994 marked a turning point where common sense prevailed over speculation. We believe that selected high quality equities are inexpensive and will outperform the bond and broader markets, while interest rates stubbornly drift higher. Accordingly, we allocate long term investment accounts as follows: 10% cash, 30% fixed income (3-5 year maturities) and 60% equities.

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Hamilton Point Investment Advisors, LLC is a fee-based investment advisory firm suitable for high net worth individuals, not-for-profits, retirement plans and corporations. We welcome comments or questions and can be reached at (877) 636-3765, or e-mail us at aburns@hamilton-point.com.

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