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Occasionally, Bulls Roar

We are in the midst of one of the strongest equity markets in history. The combination of low inflation, low interest rates and superior corporate earnings have combined to produce outstanding equity returns. For the twelve months ended June 30, 1995, conservative equities (as measured by the S&P 500) have returned 26%, while the broader Russell 2000 is up 20%. Not surprisingly, and in keeping with historical counter-cyclical returns to those in the United States, international equities are up 2.0%.

We attended an investment conference on Nantucket Island recently where 94 public companies and 160 institutional investors met to discuss the investment climate. Observations from the conference are summarized below and followed by our conclusions.

OBSERVATIONS:

GENERAL INVESTMENT OUTLOOK

Don Hayes, Chief Investment Strategist at Wheat First Butcher Singer gave a fascinating market overview. We have followed Don's excellent track record for nearly ten years. He is convinced that inflation is dead and that interest rates will stay low. He credits low inflation to ample worldwide supply of commodities and to American companies which have downsized their cost structure and computerized their operations. In addition, he believes that the maturation of the baby boomers (he actually calculates a yuppie/nerd ratio) will result in increased national savings, thereby forcing interest rates lower. He concludes that despite recent appreciation, U.S. equities are positioned for one of the best rallies ever. As you will see at the conclusion of our newsletter, we are in partial agreement with Don's view.

THE INFORMATION HIGHWAY

It was interesting to listen to the America Online presentation which literally had investors "running to the phones" to purchase shares (at 100x earnings, we might add). America Online is a leading on-line computer service company and has added 1.5 million customers to their base of 1.9 million in the last six months alone. While not a stock for us, what interests us about this company is that it demonstrates the growing demand for computers, phone lines and information. We expect that this growing demand will enhance the value of our related core holdings in Walt Disney, Time Warner, AT&T, Motorola and Hewlett Packard.

THE UNITED STATES CONSUMER

Many of the companies presenting at the conference sell their manufactured products to Walmart, K-Mart, Target, Sears, J. C. Penny, etc. These companies, who depend upon domestic consumer spending, suffered during the last six months due to higher interest rates early in the year and the resulting drop in consumer confidence. However, these companies are optimistic about the balance of 1995.

OUR CONCLUSIONS

We differ with the optimism about low interest rates and therefore maintain our asset allocation of 10% cash and equivalents, 30% intermediate term fixed income and 60% equities for balanced accounts. We are bullish on equities (i.e., 60% allocation) but our skepticism about interest rates causes us to stay relatively short in fixed income investments. We believe that current returns on long term bonds simply do not justify the risk. Inflation may be dead now, but growing worldwide demand for oil, aluminum and other commodities may cause prices to rise.

Our overriding equity theme continues to be that the world is growing faster than the United States. Accordingly, core equity holdings are in large companies, most of which have strong international markets. Examples include Johnson & Johnson, Boeing, Illinois Tool Works and Pall Corporation. The handful of companies which are strictly domestic in scope have competitive aspects about them which will allow them to prosper in a modestly growing United States. Examples include ADT, Circuit City, Heilig-Meyers and Wachovia Bank.

In conclusion, we believe that the economy will begin to grow again in the second half which will result in high corporate earnings and, unfortunately, an increase in interest rates. Although always susceptible to pullbacks, the overall outlook for equity investments is certainly positive.

Andrew C. Burns
President/Chief Investment Officer
